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TAX REVIEW

A SUPPLEMENT TO THE CANADIAN CHARTERED ACCOUNTANT SEPTEMBER 1949

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THE TAX REVIEW

PUBLISHED BY THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

[1949] September Pages 97-110

NEW ASSESSMENT NOTICES FOR INDIVIDUALS —— A PROTEST

By George Moller, C.A.

TO THEIR SURPRISE THE MAJORITY OF individual taxpayers received their assessments for 1948 shortly after filing their returns. Many chartered accountants heard sighs of relief from clients who thought their worries over. A closer inspection of the new form T67A and casual enquiry in the Department indicates that the assessment is not what it purports to be. It is in fact nothing more than a receipt or collection demand based on the unchecked return filed, in the misleading guise of an assessment.

ITA sec. 42(1) states that "the Minister shall with due despatch *examine* each return of income and assess the tax . . . . " and subsec. (2) adds that *"after examination of a return,* the Minister shall send a notice of assessment . . . "

It is physically and technically impossible to examine the avalanche of returns within two or three weeks, the time within which most of the taxpayers received their "assessments". The procedure followed is simply that, instead of writing a receipt, the cashier filled in a combined receipt and "assessment" form. It is submitted that this is a deviation from the actual meaning of the statute and an abuse of the power given to the Minister by ITA sec. 42(4) to re-assess within 6 years from the day of an original assessment or at any time, without limitation, where misrepresentation or fraud are involved. It is significant that the T67A form quotes the applicable sections (IWTA sec. 55 and ITA sec. 42); no such reference appeared on previous assessment forms Confirmation T7 or T7 IND etc.)

"Assess" is defined in Webster as "to fix or determine" and "assessment" as "act of appraising and appraising proportionate levy". It may well be claimed that the unchecked acceptance of the taxpayers return does not qualify as an act of determining or appraising.

It will impress only the unsuspecting layman to hear that all individual taxpayers have been "assessed" for 1948 within the 1949 calendar year. The effect, if not the intention, of the Department's new procedure is to leave the taxpayer in doubt whether or when his return will be really examined. Can it be that the Department has called in a psychologist on top of its legal and accounting experts Are suspension and insecurity to act as compellants to honest returning? Is sampling technique behind the new procedure? There are indications that not every return will be checked in future by assessors but that a roster will be used to examine only a certain percentage of returns, say at least one return of each taxpayer in each six year period. This would leave the Department with an opportunity of re-as-

sessing the previously not checked returns, if and when the particular individual's examined return reveals irregularities or errors of principle, not to speak of discrepancies between the taxpayer's and the Department's opinion on certain matters which lend themselves to more than one interpretation, cases which belong to every accountant's routine problems.

The taxpayer has a right to demand that all tax returns be examined by competent officers (assessors) in order to warrant a just and equitable distribution of the tax burden. It is not reasonable that a taxpayer who has made a mere mistake in addition, which he may have detected after filing his return, be "assessed" in this manner before he has had a chance to correct his mistake. Such a procedure is not apt to impress the taxpayer favourably, less still the professional accountant, who is accustomed to expect an assessment based upon proper examination of a tax return.

Streamlining of procedure can go too far. In any case it is at least not unreasonable to expect that the Department should make public announcement of changes in its basic procedure which affect the taxpayer's rights, in order to give the public a chance of adjusting itself to the new procedure. The new "assessment" form is only one example illustrating the need for closer and better public relations for the Department of National Revenue.

BRITISH COMMITTEE ON BUSINESS INCOME

THE CHANCELLOR OF THE EXCHEQUER has appointed the following committee to enquire into the computation of trade profits for tax purposes, as promised in his budget speech. Chairman is Mr. James Millard Tucker, K.C. The Revenue will be represented by Sir John J. Carer, a former chief inspector of taxes. The other members of the committee are Mr. W. S. Carrington, a leading accountant with particularly wide experience of taxation matters, and a member of the Council of the Institute; Mr. W. W. Shepherd, chairman of Turner and Newall Ltd.; Mr. H. Weston Howard, chairman of Hayward-Tyler & Company Limited and also chairman of the Eastern Regional Board for Industry; and Mr. George Woodcock, assistant general secretary of the Trades Union Congress. The secretary to the committee will be Mr. E. R. Brookes, of the department of Inland Revenue.

The terms of reference of the committee will be:—

> To enquire into the method of computing net trade profits for the purpose of charging them to Income Tax and to consider the question of the basis period to be taken in assessing the tax on the profits so ascertained; to enquire into the method of computing net profits for the purpose of charging them to Profits Tax; and to report upon any alterations of the tax law which may be desirable.

In commenting on the above announcement, *The Economist* (June 10) says:

"This is definitely encouraging. It will be seen that, although the terms follow closely those indicated in the Budget speech, it is evidently intended that the Committee's approach is not to be too narrowly circumscribed. It is, in effect, specifically charged to review the previous year basis of tax assessment and is invited to make recommendations on changes in the tax law. The task of this

committee is, of course, both more technical and much narrower than the whole question of the incidence of taxation upon industry into which an enquiry is to be set on foot eventually. But the technical question to be surveyed at this stage lies at the very roots of many of the capital problems which are troubling industry so sorely. From the very outset, the committee is bound to be confronted with the burning question of replacement costs, and of the differences between the accountants' and the economists' conception of depreciation. This committee, narrowly technical though its responsibility seems to be, has in fact the opportunity to lay the foundation for a fundamentally new approach to the vital question of taxation of business profits."

RECENT TAX CASES

Bagg v. Minister of National Revenue

(*Supreme Court of Canada, Rinfret C.J.C., Kerwin, Rand, Kellock and Estey JJ., June 24, 1949*)

Income Tax — Undistributed income of company on hand — Write-offs of goodwill disallowed — Reduction of capital — Whether irrevocable appropriation of income to capital — IWTA sec. 15

Bagg was at all material times a shareholder in a Dominion company which had been formed in 1919 with an authorised capital of 2,000 shares of a par value of $100 each, of which 1,800 shares had been issued as fully paid-up as of June 3, 1938. When formed the company included in its assets an item of $140,000 as goodwill which during the period 1921 to 1937 had been written off and charged to surplus, resulting in a reduction of capital from $180,000 to $40,000 and changing what would otherwise have been a surplus of $38,000 to a deficit of $102,000. As of June 3, 1938 the company had tangible assets to the value of $79,200 which in its balance sheets of December 31, 1937 and December 31, 1938, were listed under the headings 'cash in bank', 'accounts receivable' and an amount owing from a trust company. Pursuant to a petition for supplementary letters patent, in which it was alleged that capital to the amount of $101,800 had been lost or was no longer represented by available assets, supplementary letters patent were issued effective June 3, 1938, reducing the authorised capital from $200,000 to $79,200 by (a) cancelling the 200 unissued shares, (b) reducing the par value of each outstanding share to $44, and (c) converting the 1,800 issued shares to 1,800 preferred shares of $40 par value and 1,800 common shares of $4 par value. In 1941 the Revenue ruled that the writeoffs of goodwill by the company during the years 1921 to 1937 could not be admitted for tax purposes, and contended that in consequence the company had on hand for tax purposes a surplus of $38,000 immediately prior to the issue of the supplementary letters patent on June 3, 1938, and that under IWTA secs. 15 and 16 such amount was chargeable to the shareholders *pro rata* in accordance with their shareholdings.

For the purposes of the appeal Bagg,

the appellant shareholder, admitted that immediately prior to the issue of the supplementary letters patent on June 3, 1938, the company had on hand undistributed income to the amount of $38,000.

In testifying for appellant, the company's accountant stated that on the reduction of the company's authorised capital to $79,200 pursuant to the supplementary letters patent the undistributed income of $38,000 remained in the company as part of the $79,200.

IWTA sec. 15 provided:

> 15. When, as a result of the reorganization of a corporation or the readjustment of its capital stock, the whole or any part of its undistributed income is capitalized, the amount capitalized shall be deemed to be distributed as a dividend during the year in which the reorganization or readjustment takes place and the shareholders of the said corporation shall be deemed to receive such dividend in proportion to their interest in the capital stock of the corporation or in the class of capital stock affected. (R.S.C. 1927, c. 97, sec. 15)

Held (affirming O'Connor J. in the Exchequer Court), the assessment was properly raised under IWTA sec. 15 (Rinfret C.J.C. and Kellock J. dissenting).

Per Kerwin J.: The testimony of the company's accountant was conclusive that the undistributed income was capitalized as a result of the readjustment of the company's capital stock on June 3, 1938.

Per Rand and Estey JJ.: The company's proceedings with regard to the write-offs of the goodwill in the years 1921 to 1937 did not amount to an irrevocable appropriation of the undistributed income to capital (a "binding capitalization", Estey J.), but in view of the company's representations (Rand J.), its purpose (Estey J.), in obtaining a reduction of authorised capital to the value of the remaining assets, the reduction thereby effected amounted to such an irrevocable appropriation of its undistributed profits to capital and therefore constituted a capitalization within the meaning of IWTA sec. 15.

Appeal dismissed

Atlantic Sugar Refineries Ltd. v. Minister of National Revenue

(*Supreme Court of Canada, Rinfret C.J.C., Kerwin, Taschereau, Kellock and Locke JJ., June 24, 1949*)

Income — Nature of — Sugar refining company buying and selling sugar futures — Whether profit of trade or business — Isolated transaction — IWTA, sec. 3

While Atlantic Sugar Refineries Ltd. had power under its charter to buy and sell raw sugar on the commodity exchange, in fact its business consisted of purchasing raw sugar, refining it and selling the refined sugar, and it was not its custom to hedge its purchases by transactions in the futures market, having done so only once (in 1937) prior to the occasion in question. Following the outbreak of war in September 1939, there was a heavy increase in the public's demand for sugar, and on September 7, 8 and 9 the company, faced with rapidly depleting stocks, made cash purchases of 15,515 tons of raw sugar for future delivery at prices considerably in excess of those theretofore paid. With the intention of recouping expected losses the company sold 3500 tons short on the Exchange over the period September 11 to October 9. Of the

3500 tons 3100 were sold prior to imposition of the sugar control by the Government on October 2, following which all sugar was required to be purchased from the sugar controller at prices fixed by him. By October 27 the company closed out all its short sales by equivalent purchases, making a profit of $71,183.09 on the transactions, and thereafter, in view of the sugar control, remained out of the futures market. The company contended that the profit in question was a capital or speculative gain and not assessable to income tax.

Held (affirming Thorson P. in the Exchequer Court), the gains from the transactions were "profits from a trade or commercial or financial or other business or calling" within the meaning of IWTA sec. 3, and as such were chargeable to income tax.

Per Kerwin J. (Rinfret C.J.C. and Taschereau J.): The test in such cases is whether or not the gain is made in an operation of business in carrying out a scheme for profit-making: *Anderson Logging Co.* v. *The King* [1925] S.C.R. 45, per Duff J. at p. 48; *California Copper Synd.* v. *Harris,* 6 F., 5 T.C. 159; *Beynon* v. *Ogg* (1918) 7 T.C. 125 at p. 132, affd. (P.C.) [1926] A.C. 140; *Ducker* v. *Rees Roturbo Dev. Synd.* [1928] A.C. 132, applied.

"The company finding itself in an abnormal situation because of the various factors mentioned . . . decided to protect [its] financial interests by operations on the Exchange. The company was not investing idle capital funds nor was it disposing of a capital asset. In no sense may it be said that the operations were unconnected with the appellant's business and it is at least an added circumstance that the speculation was made in raw sugar. Even if it were the only transaction of that character, it should be held, in the light of all the evidence, that it was part of the appellant's business or calling and therefore a profit from its business within sec. 3 of the Act."

Per Locke J. (and Kellock J.): ". . . in the ordinary case of a hedge, the selling for future delivery synchronizes with the purchase of the commodity while in the present case the short sales were made over the period of a month following the cash purchases. I think that this circumstance does not affect the matter to be determined. While not carried out contemporaneously with the purchases the short sales were in effect a hedge by the company against a possible loss on the purchases made and it was only the imposition of control on October 2 that rendered further hedging operations inadvisable. In trades where natural products are purchased in large quantities, hedging is a common, and in some cases, a necessary practice, and the cost of such operations in trades of this nature is properly allowable as an operating expense of the business. Where, as in the present case, the trader elects to close out his short sales and take a profit, this is, in my opinion, properly classified as profit from carrying on the trade."

Appeal dismissed

Cooper v. Minister of National Revenue

(Exchequer Court of Canada, Angers J., June 8, 1949)

Office or employment — Income from — Deduction of union dues from wages — Payment of union dues essential to membership in union — Membership in union a condition of employment — IWTA sec. 6(1)(a)

Cooper, a member in good standing of a motion picture projectionists' union, was employed as a projectionist by a theatre operator. The employer was bound by a contract with the union under the terms of which the employer undertook to employ only projectionists supplied by the union who were in good standing with the union. Under the union's constitution and by-laws union dues were required to be paid in advance, and default of payment would have made Cooper liable to forfeiture of his membership in the union and to loss of his employment. In 1945 Cooper paid union dues of $37.50 and contended that this sum was deductible from his income, viz., his salary as a projectionist, in ascertaining his taxable income for the year.

Sec. 6(1)(a) of the *Income War Tax Act,* R.S.C. 1927, c. 97, provides:

> In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of
> (a) disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income.

Held, Cooper was entitled to deduct his union dues in ascertaining his taxable income for the year, and the appeal must be allowed: *Bond* v. *MNR,* [1946], Ex. C.R. 577, C.T.C. 281, followed.

Per Angers J.: "I see no difference, for the purpose of income tax, between a member of the bar who is required to make an expenditure in order to be authorized to carry on his profession and a projectionist or, in fact, any other worker, who is bound to pay dues and assessments to form part of a [union] which provides the jobs. Whether the expenditure be prescribed by the charter or by-laws of a law society or by a contract or agreement between the employer and a union seems to me immaterial. In each of these alternatives the lawyer or the projectionist has to pay a fee to be authorized to carry on his profession or trade. If the appellant had not remained a member in good standing of [the union] he would not have obtained a position as a projectionist . . . "

[*Wales* v. *Graham,* 24 T.C. 75; *Simpson* v. *Tate,* 9 T.C. 314, *Siscoe Gold Mines Ltd.* v. *MNR* [1945] Ex. C.R. 257; *Montreal Coke and Mfg. Co.* v. *MNR* [1944] A.C. 126; *Mahaffy* v. *MNR* [1946] Ex. C.R. 18, distingushed]

Appeal allowed

EDITOR'S NOTE: This decision has no application to taxation years governed by the new *Income Tax Act,* 1948, c. 52, that is, to 1949 *et seq.* Sec. 5 of the new Act defines income from an office or employment and the permissible deductions therefrom with precision, and it renders both the *Bond* and the present case inapplicable.

Pan-American Trust Co. v. Minister of National Revenue

(Exchequer Court of Canada, Thorson P., July 20, 1949)

Non-resident parent company.— Withholding tax — Dividends and interest paid to resident trustee for parent company — Whether entitled to exemption — IWTA sec. 9B(2) (a), (d), 9B(11), 9B(12)

A Swiss drug company not resident in Canada had two Dominion-incorporated subsidiary companies, an operating company and an investment company, the latter being within the definition of a non-resident owned investment corporation under IWTA sec. 2(1)(p). In 1940 because of war conditions the Swiss company had a trust company incorporated in Prince Edward Island and transferred to it, pursuant to an agreement, substantial blocks of its shares in the two Dominion subsidiaries as well as certain 5% promissory notes of the subsidiary operating company. In the succeeding years dividends on the shares of the two Dominion subsidiaries and the interest on the notes (less, in the latter case, 15% tax withheld by the payer), instead of being paid direct to the Swiss company as theretofore, were paid to the trust company, which credited the sums received to the Swiss company in a special account and kept them in a separate trust bank account. The trust company purchased Dom. of Canada bonds with a portion of the moneys so received as dividends and dealt with the interest thereon in precisely the same way. It did not withhold income tax on any of the sums so credited to the Swiss company, whereupon the Revenue demanded payment of tax from the trust company (pursuant to IWTA sec. 84) for 1941, 1942 and 1943, contending that all the sums credited to the Swiss company were subject to the 15% withholding tax imposed on non-residents under IWTA sec. 9B(2) (d) as being "income received from a Canadian estate or trust". The trust company appealed.

IWTA sec. 9B(2) imposes a tax of 15% on non-residents of Canada in respect of, *inter alia,* the following:

(a) all dividends received from Canadian debtors . . . , and

(b) all interest received or credited by Canadian debtors . . . except the interest from all bonds of or guaranteed by the Dom. of Canada.

(c) all interest received by a non-resident parent company from a Canadian subsidiary company . . .

(d) all income . . . received from a Canadian estate or trust, which income shall be deemed to include all income accruing to the credit of non-resident beneficiaries whether received by them or not . . .

Sec. 9B(11), however, provides that no tax is payable under sec. 9B(2) in respect of dividends received by a non-resident company from a resident subsidiary company having certain qualifications. (The Swiss company's subsidiary Dominion operating company was so qualified.)

Sec. 9B(12) also exempts from the tax imposed by sec. 9B(2) [under certain conditions, which are not relevant here] dividends paid or deemed to be paid by non-resident owned investment corporations (para. (*a*)), and interest payable by non-resident owned investment corporations (para. (c)).

Held, no tax was payable under sec. 9B and the appeal must be allowed.

1. *The Dividends*

The various paragraphs of sec. 9B(2)

are mutually exclusive of one another, and therefore any tax in respect of "dividends from Canadian debtors" must arise under para. (a) only; it cannot also arise under para. (d) as being "income received or accruing from a Canadian estate or trust".

Moreover, in the absence of clear and compelling words an interpretation should be avoided which would lead to the anomaly that the tax would not be payable in respect of the dividends if they went out of Canada to the non-resident but would be payable if they went to a trustee in Canada for the non-resident.

When the dividends from the two Dominion subsidiaries were paid to the appellant and credited by it to the Swiss company the latter became the beneficial owner of such dividends and entitled to the amounts thereof in their character as dividends and not as income received or accruing from a Canadian estate or trust: *Archer-Shee* v. *Baker* [1927] A.C. 844, 11 T.C. 749, applied; and payment of the dividends to the trust company, which received them for the Swiss company, their beneficial owner, was sufficient payment to meet the requirements of sec. 9B(11) and (12) and entitle them to exemption thereunder.

Further the term "estate or trust" in sec. 9B(2)(d) does not extend to the relationship between the Swiss company and the trust company, for the former never ceased to be the beneficial owner of the shares and other property transferred by it to the trust company.

Semble: The term "income received or accruing from a Canadian estate or trust" (sec. 9B(2)(d)) does not include income from property which a settlor has transferred to a trustee for himself and of which he has never ceased to be the beneficial owner.

2. *Interest on Dom. of Canada Bonds*

The Swiss company was the beneficial owner of the bonds and of the interest thereon in its character as interest and not as income received or accruing from a Canadian estate or trust, and the demand for tax thereon failed. Further, such interest was clearly exempt from tax in virtue of sec. 9B(2)(b).

3. *Interest on Subsidiary's Notes*

The claim for tax on the interest on the subsidiary operating company's promissory notes also must be rejected in view of the fact that it had already withheld and remitted the 15% tax thereon.

Appeal allowed

EDITOR'S NOTE: Prior to the pronouncement of judgment in this appeal the Revenue withdrew its demand for tax in respect of the dividends received by the trust company from the non-resident owned investment company consequent upon enactment by Parliament of the following retroactive provision, 1948, c. 53, sec. 6(3):

> Where all or any part of income received by a non-resident person for a taxation period from a Canadian trust can reasonably be regarded as having been derived from dividends or interest received by the trustee from a non-resident owned investment corporation on which no tax would have been payable under sec. 9B(2) if they had been paid by the non-resident investment corporation to the non-resident person instead of to the trustee, no tax is payable thereon under sec. 9B(2)(d).

Thorson P., however, holds in the present judgment that the Crown's claim was in any event unfounded under the law as it stood prior to the amendment.

McDonough v. Minister of National Revenue

(Exchequer Court of Canada, Cameron J., August 4, 1949)

Trade or Business — Isolated transaction — Profit made in operation of business in carrying out scheme for profit making — Promotion and development of mining company by prospector — Purchase and resale of shares — IWTA sec. 3

For some ten years prior to May, 1939 McDonough was engaged mainly in exploring for and prospecting for mines either on his own account or for various mine development companies, but prior to May, 1939 had never taken any part in the promotion of companies or the raising of capital for mining development. On being released from his employment with a mining development company on May 1, 1939, he conceived the idea of bringing several adjoining mining properties into a company to be formed by him and to obtain funds from others for their development, he having no funds of his own for financing the project. He succeeded in obtaining options on the various properties with the assistance of another person (to whom he agreed to pay one-half the profits derived from the options), and negotiated a contract with the owners of the properties providing for the transfer of the properties to a company to be formed to acquire and develop the properties, and for the granting to McDonough of options to purchase blocks of treasury shares of the company at certain times and at certain prices. The agreement was later ratified by the company when formed. Previously McDonough, as a result of his efforts to interest certain mining companies in his project, had obtained a contract from one such company to purchase from him at slightly advanced prices the shares of which he then obtained options to purchase under the above-mentioned agreement. McDonough then had the company formed, becoming its general manager and later its director, and the various contracts were all carried out, McDonough making a substantial profit on the purchase and sale of the shares in the years 1939, 1940 and 1941. The above proceedings occupied his entire time and attention from May to December 15, 1939, when he was called up for war service, and after that date he continued to give advice as to the development of the properties when called upon from time to time.

Held, the profits in question were chargeable to income tax as being profits or gains derived from a trade or business: IWTA sec. 3. [*Jones* v. *Leeming* [1930] A.C. 415, distinguished; *Collins* v. *Firth-Brearly Stainless Steel Syndicate,* 9 T.C. 564; *Rutledge* v. *C.I.R.,* 14 T.C. 490, applied].

Per Cameron J.: It was McDonough's intention to use his knowledge and experience and to go into the business of promoting mines on his own account. "And what he did may properly be called his business. It engaged his entire time and attention from May, 1939 to December 15, 1939, and was discontinued only because he was recalled for duty in the Forces. It included all those matters which would normally be carried out by one in the business of a mine promoter, namely, the location of properties, securing options, the merging of all the properties, the formation of a new company and the arranging of finances for the necessary development.

". . . it is quite apparent . . . that

his purpose throughout was to make a profit for himself . . . Now the only way in which it was possible for him to make a profit . . . was to dispose of the shares . . . on which he held options, at prices exceeding those which he was obliged to pay . . . The appellant, therefore, was not only engaged in the business of promoting the company, but of underwriting its shares, the latter being an essential feature of the business so far as the appellant was concerned, if not the main feature.

"In the present case there can be no doubt whatever that the sale of the shares which gave rise to the profits now assessed . . . was not merely incidental to but in reality the essential feature of the whole business carried on by the appellant. It was a gain made in an operation of business in carrying out a scheme for profit making and is, therefore, properly assessable to tax." [*California Copper Syndicate* v. *Harris*, 5 T.C. at 165 ff., followed]

"The appellant, however, further submits that the purchase and re-sale of the shares was an isolated transaction outside of his usual business operations and unconnected therewith, and that, therefore, the profits were not made from a trade or business. It is true that in the years in question the appellant bought and sold shares only in one company and that all the purchases arose under [one] agreement and all the sales originated under [one] agreement. From another point of view, however, they were not single transactions inasmuch as the sales and purchases aggregated over 1,000,000 shares and were made over a period of more than two years. But the mere fact that a transaction is an isolated one does not exclude it from the category of trading or business transactions of such a nature as to attract income tax to the profit therefrom. Thorson P. in *Atlantic Sugar Refineries Ltd.* v. *MNR* [1948] Ex. C.R. 622 at p. 631, referred to the cases which support that proposition. [*T. Beynon & Co.* v. *Ogg* (1918) 7 T.C. 125, referred to; *Com'rs of I.R.* v. *Livingston* (1926) 11 T.C. 538, applied; *Income Tax Case No. 118*, 4 South Africa T.C. 71, referred to.]

Appeal allowed

Joggins Coal Co. v. Minister of National Revenue

(*Exchequer Court of Canada, Cameron J., August 18, 1949*)

Depletion Allowance — Mining Leases — Apportionment between lessor and lessee — Failure of parties to reach agreement — Discretion of Minister absolute IWTA, sec. 5(1)(a)

In 1937 the Tantramur Coal Co. purchased for a substantial sum certain coal mining leases which had first been granted by the Province of Nova Scotia in 1923 and had since been the subject of a series of assignments. In June 1939 the Tantramur Co. granted to one W. the right to mine the coal in one of the seams for a royalty ranging from 5c to 10c per ton, W. also undertaking to pay royalties to the Province. In September W. assigned all his interest in the above agreement to the Joggins Coal Co. The Joggins Co. paid nothing at the time, and the only capital cost to it of the coal it mined in the years following was the total of the royalties paid to the Province and to Tantramur, all of which were allowed as deductions from its income for tax purposes. In the taxation years

1939, 1940 and 1941 both the Tantramur Co. and the Joggins Co. claimed a deduction from their respective incomes of the full amount allowed by the Minister for depletion allowance, viz. 10c per ton mined. The two companies were unable to agree on an apportionment of the allowance between them, pursuant to IWTA sec. 5(1)(a), and the Minister thereupon apportioned it between them by giving the Tantramur Co. the whole of the 10c allowance per ton to the amount of the royalties received by it (which in 1939 amounted to 10c per ton but in the years 1940 and 1941 averaged less than 10c per ton), and giving the Joggins Co. the balance of the allowance in the two latter years.

IWTA sec. 5(1)(a), as it was in 1939, provided:

> " . . . the Minister in determining the income derived from mining . . . *shall* make such an allowance for the exhaustion of the mines . . . as he may deem just and fair, and in the case of leases . . . the lessor and the lessee shall each be entitled to deduct a part of the allowance for exhaustion as they agree and in case the lessor and the lessee do not agree, the Minister shall have full power to apportion the deduction between them and his determination shall be conclusive. (R.S.C. 1927, c. 97, sec. 5; am. 1928, c. 12, sec. 4)

For the years 1940 and 1941 sec. 5(1)(a) was in the same terms except that the word "may" was substituted for the word "shall" italicised above (1940, c. 34, sec. 10).

The Joggins Co. contended that it was entitled to the whole of the depletion allowance for the years in question on the ground that the Province of Nova Scotia was lessor of the mines and was exempt from taxation or, alternatively, if the Tantramur Co. was the lessor, that the apportionment made by the Minister should be amended.

Held, the appeals must be dismissed.

While sec. 5(1)(a) conferred a statutory right to a depletion allowance in 1939, though not in 1940 and 1941 (*Pioneer Laundry & Dry Cleaners Ltd.* v. *MNR* [1939] 4 D.L.R. 481; *D. R. Fraser Co.* v. *MNR* [1948] 4 D.L.R. 776), the apportionment of the allowance between a lessor and lessee in the absence of agreement between them was solely within the discretion of the Minister and not subject to review by the Court even though he allot the whole of the allowance to the lessor and none to the lessee. In any event it was not shown that the Minister in exercising his discretion had violated any sound and fundamental principles.

It was not necessary to decide whether the Joggins Co. were lessees of the mine or, as contended by the Minister, merely licensees with an interest, or whether the Province of Nova Scotia or the Tantramur Co. were lessors. In either case the Joggins Co.'s position with regard to the depletion allowance under the apportionment provisions of sec. 5(1)(a) was the same. If the Province of Nova Scotia were held to be the lessor, the fact that it was not a taxpayer was irrelevant. The Minister's duty was to apportion the allowance between a lessor and lessee taking into consideration their relative interests in the capital asset being exhausted and not on the basis of whether or not they were or were not taxpayers.

Appeals dismissed

Cossitt v. Minister of National Revenue

(Exchequer Court of Canada, O'Connor J., July 23, 1949)

Succession Duty — Dominion — Bequest of life interest in income with power to encroach on capital — Whether a general power of appointment — Disclaimer of power — Lex domicilii testatoris governing law — Succession Duty Act, 1940-41, c. 14, secs. 2(m), 31

By her will, testatrix who died on March 15, 1944, domiciled in Ontario, gave the residue of her estate to her executor, the appellant, in trust to pay the income therefrom to himself during his lifetime, with power to appellant at any time to use for his own benefit such amount of the capital as he might wish, and with a gift over of the remainder for such of the issue of the appellant as the latter might by his last will direct. Dominion succession duties were initially calculated on the basis of appellant having only the income of the residue for life, and Ontario succession duties were paid on the same basis. Nearly 3 years later the Dominion demanded additional duty on the basis that under the will appellant received a gift of the entire residue. Upon receipt of the assessment notice appellant executed a disclaimer of the power to encroach on the capital, and appealed from the additional assessment. Appellant testified that he had never exercised the power to encroach and had no intention of doing so prior to the execution of the disclaimer.

Held, the appeal must be allowed.

The power conferred on appellant to encroach on the capital of the residue for his own benefit was not property, and accordingly such power did not constitute a succession under sec. 2(m) of the *Dominion Succession Duty Act,* 1940-41, c. 14: *Re Miller's Agreement, Uniacke* v. *Att'y.-Gen.* [1947] 2 A.E.R. 78, but notwithstanding that it was not a power to appoint and was exercisable for the benefit of appellant only, it was "a general power to appoint property" within the meaning of that phrase in sec. 31 of the Act, and accordingly constituted a succession of such property under sec. 31: *In re Richards, Uglow* v. *Richards* [1902] 1 Ch. 76; *Re Ryder, Burton* v. *Kearsely* [1914] 1 Ch. 865; *In re Shuker's Estate, Bromley* v. *Reed* [1937] 3 A.E.R. 25, followed.

However, under sec. 24 of the *Law and Transfer of Property Act,* R.S.O. 1937, c. 152, which, being the law of the domicile of the testatrix, was the governing law, (see *Fitzgerald* v. *MNR* (Can. S.C.), not yet reported) appellant was entitled to disclaim the power to encroach without disclaiming the gift of the income, and the effect of the disclaimer was to void the power *ab initio.* See *Silcock* v. *Roynon* (1843) 2 T. & C. Ch. Cas. 376, 124. On the evidence it must be found that appellant did not exercise the power nor did he intend to do so, nor did he by acquiescence accept the power prior to disclaiming it.

Appeal allowed

THE INCOME TAX REGULATIONS

P.C. 3726, July 26, 1949

HIS EXCELLENCY the Governor General in Council, on the recommendation of the Minister of National Revenue and under the authority of section 106 of The Income Tax Act, Chapter 52 of the Statutes of 1948, is pleased to make the attached regulations entitled "The Income Tax Regulations, Part IX" and "The Income Tax Regulations, Part X", and the said regulations are hereby made and established accordingly.

Canada Gazette, August 10, 1949

PART IX

Delegation of the Powers and Duties of the Minister

Sec. 900

900. (1) The Co-ordinator and Chairman of the Executive of the Taxation Division of the Department of National Revenue may exercise all the powers and perform all the duties of the Minister under the Act.

(2) The District Directors may exercise the powers and perform the duties of the Minister under the following provisions of the Act:

(*a*) subsec. (2) of sec. 40,
(*b*) subsec. (2) of sec. 49,
(*c*) para. (*g*) of subsec. (1) of sec. 106,
(*d*) sec. 109,
(*e*) sec. 114 and
(*f*) subsec. (2) of sec. 115.

(3) The Director General Legal Branch, and the Assistant Director General Legal Branch of the Taxation Division of the Department of National Revenue may exercise the powers and duties of the Minister under the following provisions of the Act:

(*a*) subsec. (2) of sec. 40,
(*b*) sec. 108,
(*c*) subsec. (1) of sec. 111 and
(*d*) subsec. (2) of sec. 115.

(4) The Director of Intelligence and the Assistant Director of Intelligence of the Taxation Division of the Department of National Revenue may exercise the powers of the Minister under subsection (2) of section 40 and subsection (2) of section 115 of the Act.

Sec. 901

901. For the purposes of this Part, "District Directors" mean the Directors General of Income Tax and Succession Duties and Directors of Income Tax and Succession Duties of the Taxation Division of the Department of National Revenue.

PART X

Dependents

Sec. 1000

1000. (1) The class of persons who may be regarded as dependent for support on taxpayers during a taxation year for the purposes of the Act is every person who qualifies as a dependent of the taxpayer under the provisions of the Act during a taxation year and whose income for the year does not exceed $500.

(2) For the purposes of this section, income does not include income from employment as a nurse in training.

CASES ABRIDGED

REGULATIONS, ORDERS IN COUNCIL

THE INCOME TAX REGULATIONS

REVENUE DIRECTIVES

The Canadian
Chartered Accountant

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VOLUME 55 SEPTEMBER 1949 NUMBER 3

COMMENT AND OPINION

The Annual Meeting

THIS issue will reach your desks soon after the conclusion of the forty-seventh annual meeting in Toronto, which it is hoped will have been for all an informative and pleasant occasion. The papers read and committee reports will be published in the usual way during the next few months.

Looking backwards over 20 years, the development of these meetings is most interesting. Then the main purpose was one of foregathering and entertainment; the business of the Association had been conducted by one or two committees who reported in a rather perfunctory way; and it was customary to obtain a principal speaker, unconnected with the profession, who delivered what might be called another baccalaureate address. Our prospective high place in the community was seen dimly by him and not a great deal more clearly by some of the rest of us, particularly the younger members who did not find the gates of fortune opening as quickly or as widely as had been expected. The older members were reticent about putting themselves forward and leaving themselves vulnerable to attack from other older members. The editor of *The Canadian Chartered Accountant*, with an issue every two months, was frequently at his wit's end for material. It did not seem to be decent to express one's own views on the state of the profession nor on the state of the published accounts. A few hardy souls would seek advice at the annual meeting session under the heading of "New Business", but would receive little attention as the afternoon was wearing thin and other pleasures and interests beckoned.

No doubt this was true also of the other professions at similar stages in their lives and perhaps at the same time in the late Twenties. Since then there seems to have been an awakening in two directions. First, we have acquired an entirely fresh view on our duty to the public, and, second, we have learned, with others it is true, that a way to advance is to commune together, to make available to others the fruits of our experience, and to come to joint conclusions on the appropriate techniques and responsibilities of the profession. This is well exemplified in the host of organizations which has sprung up in the business field, and hardly a day passes by without one's reading of a meeting devoted to technical discussions by groups of business men such as controllers, purchasing agents, cost accountants, internal auditors and so on. Rarely now do they conduct a business meeting and sit down to dinner to listen to a guest speaker discoursing on a general subject. Ordinarily, they listen to one of themselves putting forward his views

on the general state of affairs in their special field of interest for the benefit of all the members.

We think this is fine, but we do not understand what brought it all about. Is it the progression expected by the leaders, who, for example, formed our Institutes in the last 50 to 75 years? Did they envisage this swing to wide dissemination of advice and experience by leaders in the profession? It is recalled that one of the principal topics of discussion years ago was Ethics and Business Practices. Little was said about how one conducted the business after one got hold of it. Is it just a matter of first things first and then moving ahead to the next step? Our great interest now is to find and then report the best and most appropriate way to do our duty as we see it and this "as we see it" also changes with the times. Perhaps after all, it is merely the result of growing up. The mind of a group acquires experience with the maturity of the group without regard to the ages of the individual members of the group. If this is so, we have great things to look forward to, provided that we watch that the mind of the group does not become senile with old age.

What Is a Profession?

The Journal of Accountancy, August 1949, contains as editorial comment the following paragraphs under this heading. We think that the writer has most ably summarized the objectives of the public accountant and are pleased to give the statement a position of prominence in this issue.

In an article discussing the legal profession, Fortune recently said that a trade is a profession only if, in addition to all else, it is powered by a sense of mission. Mr. Justice Holmes was quoted: "How can the laborious study of a dry and technical system, the greedy watch for clients . . . the mannerless conflicts over often sordid interests, make out a life? . . . If a man has the soul of Sancho Panza, the world to him will be Sancho Panza's world; but if he has the soul of an idealist, he . . . may live greatly in the law as well as elsewhere."

We believe that the accounting profession is "powered by a sense of mission", though the mission may not yet be clearly defined. A recent president of the American Institute of Accountants suggested that the task of the certified public accountant was to be the guardian of the conscience of the business community. Perhaps that is pretentious, but it embodies the idealism which Justice Holmes would have approved.

At least it may be asserted that the accounting profession's mission is to find the truth, and develop order and clarity, in the complex economy of these times. When one considers the vast network of accountability which links the various elements of society, it is evident that reliance on financial reports of various kinds is essential in the structure of credit, investment, trusteeship, taxation and government regulations.

To sustain the credibility of such reports — to make them reliable — is a task of noble proportions. It requires technical skill and precision in the design of accounts and record-keeping, experienced judgment in auditing, and an objective view of the needs of all concerned in a fair and unambiguous presentation of the results.

To maintain confidence in financial reporting seems a sufficiently high mission to support the claims of accounting to professional status.

Is It Good Business?

By Bradford Cadmus

An argument for the use of judgment in the application of accounting principles to practical problems

WE INHABITANTS of this continually changing world are constantly met with the necessity for revision of our thoughts and our philosophy to keep in step with our times. Subconsciously and instinctively our first reaction is against almost anything that requires a revision of our thinking. We are for maintenance of the *status quo*, for things as they are.

A part of this reaction is the continual effort to develop certain fixed and changeless rules which may be used as foundation stones for our thinking and our actions. These rules have names which vary according to the branch of knowledge that they cover. In geometry, they are called axioms; in the sciences, physical laws. They are often not susceptible to proof; they appear logical from observation and, because of this logical appearance, serve as the foundation of elaborate structures of reasoning. For example, our science of geometry is built upon axioms such as "A straight line is the shortest distance between two points".

The truly profound thinkers are those who attack not the superstructure, but who rather question the rules themselves. When they can successfully prove that what has been taken for granted is doubtful or wrong, the whole beautiful structure falls in a heap. In our own times, we have seen the entire science of astronomy modified because Einstein questioned and proved that light did not always follow a straight line. More recently the orderly, and apparently natural, separations between physics and chemistry and between organic and inorganic chemistry have been utterly demolished. The division of the atom has upset everything.

Application to Auditing

In our own field of auditing there is often a tendency to lean upon similar standards as the basis for appraisal and judgment. It would be excellent if a set of auditing and accounting axioms could be applied in any situation. In our human tendency to have some set marks to go by, we are prone to set up axioms of our own or to adopt for our use some of the rules which have been previously proposed by others.

The use of a code of rules simplifies the auditor's task exceedingly. In the first place, the rules provide him with a set of yardsticks against which to measure actual performance. Any deviation is either right or it is wrong, and final and complete judgment is possible. Another advantage of a set of rules is that it places the auditor in a position where, in

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case of any question, he can figuratively shrug his shoulders and refer to authority beyond and above him.

With all of this business of rules as the final basis of judgment, we are in complete disagreement. There are no sure-fire, universally applicable rules in accounting and auditing. Below are given some examples of practices that on the surface may appear to violate what many would consider to be fundamental principles. Yet we believe that a common-sense consideration of the apparent violations will bring some doubt to the mind of the most conservative.

The Examples

The three examples which are cited pertain to cash since cash and its handling have understandably been afflicted with more dogma than the other branches of accounting. Naturally, the reason for this is that cash is the universally acceptable medium, it is the ultimate goal of any defaulter.

1. *Bank Reconciliations*

The reconciliation of bank accounts is a sacred principle in almost any business. Yet in one business that handled about 10,000 cheques each year in each of a number of accounts, practically no reconciliations were made. • The cheques were small in amount, and were all issued to growers of a crop upon its delivery to a receiving station during a two-month period. The reports of purchases and corresponding payments were carefully checked into inventory, and each day a bank deposit equal to the value of the purchases was made. In other words, the bank accounts were run on an *imprest* basis. The usual bank statements were rendered, but not checked in any manner. If the difference between the established and actual balances was within $100 three months after the close of the season, no reconciliation was made and the account was closed out until the next year. Would the satisfaction of having the reconciliation justify the expense? Why?

2. *Listing of Cash Receipts*

Another favorite principle is that of pre-listing cash receipts in a mailing department. Now, let us look critically at a situation where an office maintains only customers' accounts, no currency is handled, all checks received are payable to the company and cannot be cashed by any person except an officer located in the home office 1000 miles away. Is there any reason for a pre-listing, just for the purpose of subsequent comparison with the credits to customers? What can go wrong if we have no pre-listing?

3. *Inviolability of Cash Receipts*

The rather long word expresses the sacred nature of incoming cash, which many auditors insist must be deposited intact, almost without even changing a half dollar for two quarters. In the case in mind, salesmen settled with considerable quantities of currency as well as cheques made out to various payees which were turned over to the salesmen by customers.

The auditor questioned the cashing of company pay cheques out of the available currency — thus substituting a company cheque but not affecting the total amount of the deposit which still agreed with the settlements from the salesmen. The local manager then asked the auditor: "Now it is wrong to cash Bill Jones' cheque from the receipts?" Answer, "Yes". Next question: "Would it be all right for Bill Jones (or his wife) to cash the cheque at XYZ store?" Answer "Yes". Next question: "Now, would it be all right for XYZ store to give Bill Jones' cheque — previously cashed by the store — in payment of XYZ's account?" Answer, "Ye-s-s". Next question: "Well, what's the difference — whether Bill's

wife cashes it at the store or Bill cashes it here?"

The Purpose of Rules

In each of the examples we have a definite deviation from a rule that was used by an auditor as authority and basis for critical comment. But the strict application of the rule brought about a violation of the principles of common sense and business judgment.

All of which leads us to the conclusion that in auditing the ultimate and final rule is that of common sense and business judgment. There are no hard-set principles invariable under all conditions; there are no axioms in auditing. When we "'throw the rule book" we are invoking authority instead of common sense.

Rules have their value as indicators, but never as the standard of final judgment. A violation of a generally accepted rule or principle is reason to examine and appraise more closely, to insure that adequate control exists.

The Standard of Final Judgment

Rule books and manuals are comforting things to have about in the ever-changing business scene. They are signposts, pointing the way; but they are not goals or ends in themselves. The fact is that most advance and progress in accounting, as well as in science, is made by those who have the courage, or the intelligent laziness, to deviate from the prescribed routine, substituting some other that has a greater practical appeal.

So, when we find a variation, it must be judged not by the books but by the standards of business sense—

1. Do we have effective operation?
2. Do we have economical operation?
3. Do we have adequate control?
4. Does it make sense?

In short, is it good business?

Conclusion

When we make our final judgment on the basis of good business, we are on solid ground; we can reach a conclusion that will be the most logical and defensible to management, accountant and auditor. The auditor should always ask himself "Why?" and never take any answer but the one that is reasoned out and acceptable to himself, because that is the best one for his business.

CONFERENCE OF INTERNAL AUDITORS

THE Institute of Internal Auditors is holding its annual conference this year in Toronto at the Royal York Hotel on October 9, 10 and 11. This is the first time that the Institute will have held its annual conference in Canada and a record attendance is expected, due partly to the novelty of visiting this country so far as American members are concerned.

Papers on frauds, inventory control, and operational audits will be given at part of the conference. An all-day session on the 11th will be devoted to group discussions of control problems affecting particular industries, since the nature of the Institute is such that most of the members are from the larger corporations on this continent. Visitors are welcome to these sessions.

The general chairman of the conference is W. J. L. Townsend of Canada Packers Limited, and the international president of the Institute this year is A. J. E. Child of the same company. Information regarding programmes may be obtained from Mr. Robert C. Baird, Canada Life Assurance Company, University Avenue, Toronto.

A Recent Book

Introduction To Accounting by Robert R. Milroy and Geoffrey L. Carmichael: Houghton Mifflin Company, 1949, pp. 855 and index.

If the test of a text book is that it is "self teaching", then this book is a good one. It should be possible to ascend a spiral staircase to an ivory tower with a copy of *Milroy and Carmichael* under one's arm and to emerge some time later with a sense of achievement.

The book contains separate but brief chapters on the verification of closing balances, job order cost accounting and process cost accounting that may have something to be said for them. They are commendable if they tie in the subjects of auditing and cost accounting with accounting as a whole.

An innovation which the authors have introduced (at least the writer has not seen it before) is the use of red lines to cross-reference certain figures in ledger accounts, books of original entry and financial statements where the authors wish to emphasize something in particular. The lines are faint and the idea is not overdone; for which we may all be extremely grateful. In less discreet hands it could have been horrible. Within its present bounds the device is probably quite helpful.

The authors' introduction of work sheet technique at an early point meets the American demand for columnar presentation and keeps the market for 14-column paper buoyant. The English and Canadian practice of managing somehow to prepare financial statements directly from a preliminary trial balance and supplementary information must seem an act of sheer wizardry to our American friends. In the reviewer's opinion the explanation of the work sheet is best deferred and introduced later merely as a useful device in practice for the preparation of *interim* financial statements when the accounts would not actually be closed out.

In the reviewer's opinion the authors were not up to their usual standard in introducing control accounts and subsidiary ledgers. Of course no matter what one does, says, or writes, there will always be students who think that the control account "balances" because it is posted directly from the subsidiary ledger. But the number of such students can possibly be reduced by emphasizing that control accounts are part of the system of internal check, and provide an independent check of one clerk's work by another. The idea of the independent check was possibly not exploited enough.

The publisher's advertisement states that the book has an interesting style. It is really something to sustain an interesting style for 855 pages but the publishers appear to be correct. The authors must have worked in relays. They have achieved their effectiveness through the use of short sentences and familiar words. The reviewer does not recall any instance of an obscure phrase.

J. E. Smyth, C.A.

Case Studies in Internal Auditing

By A. J. E. Child
(President, Institute of Internal Auditors)

A detailed study of the internal auditor's function in a large Canadian industry

TO PARAPHRASE the Institute of Internal Auditor's *Statement of Responsibilities,* internal auditing is a practical technique designed to accomplish the following:

1. Ascertain the degree of reliability of accounting and statistical data developed within the organization.
2. Ascertain the extent to which company assets are properly accounted for and safeguarded from losses of all kinds.
3. Ascertain the extent of compliance with established policies, plans and procedures.
4. Review and appraise the policies and plans of the organization in the light of related data and other evidence.
5. Review and appraise the internal records and procedures of the organization in terms of their adequacy and effectiveness.
6. Review and appraise performance under the policies, plans, and procedures.

It will be realized that this is no small assignment for a staff group within a corporate organization. Such staff must be well trained and adequate in numbers. To illustrate, one corporation in this country has a budget for internal auditing of approximately one million dollars.

As illustrations of the foregoing, three groups of case studies are presented:

1. Routine internal audit functions.
2. Special assignments to determine the efficiency of an operation.
3. Special investigations of fraud and theft.

The experiences and practices utilized are for the most part drawn from our own company. Because the meat packing industry is one of the less-publicized (perhaps due to its lack of any glamour), it is necessary to give a brief description.

The Meat Packing Industry

Our company processes and markets meat, poultry and dairy products, vegetable oils, fruits, vegetables, fish, mineral fertilizers, and the by-products of all these. The physical equipment consists of packing plants, cold storages, oil refineries, creameries, canneries, fertilizer and feed plants, leather tanneries, and wholesale warehouses, about eighty units altogether. These extend all across Canada and into some parts of the United States. The annual volume of business is about 250 million dollars.

There are special control problems in an industry of this kind:

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1. Because of the wide geographical spread of the various units, supervision by remote control is necessary and complicated. The internal audit department is, therefore, regarded very much as the eyes and ears of management.

2. The management and accounting systems are highly decentralized. Down to the smallest unit, local management has wide powers of initiative and action, and all accounting records up to a general ledger are kept locally. The control of cash, receivables, and payables is local. This requires frequent and detailed audits of the smaller units, although at large plants good internal check can be operated by local management

3. The nature of the products handled requires special safeguards against spoilage and theft. An internal auditor must constantly check the conditions of merchandise, the storage and warehousing facilities, and the effectiveness of inventory control.

The internal audit department in our company consists of ten auditors of varying degrees of experience, plus several clerical assistants. This is somewhat small for adequate coverage. At present the size of the staff is limited by the number of senior auditors available to give on-the-job training, a necessity no matter what the previous experience of a new man may have been.

Every corporation has its own ideas of the services its internal audit department should provide. In brief, our company wants the following:

1. The objective reporting of inefficiencies and sub-standard work, along with recommendations for correction and improvement.

2. Prevention and detection of fraud and theft, preferably prevention.

Regarding the first of these objectives, the following instructions are given to our auditors:

In any department, determine first of all the reason for that department's existence. What is it supposed to do? Then ask yourself if, with the material it has to work with, it achieves its purpose in the shortest possible way.

Routine Assignments

What might be called *routine assignments* include three main sections of our audit program, namely, accounts payable, accounts receivable, and inventories.

Accounts Payable

Every one of our units pays its own bills locally. Purchases of raw material and saleable merchandise are almost completely under local control. Expenditures for equipment and supplies in excess of certain amounts are subject to head office authorization.

The internal audit department, therefore, faces the following problems:

1. In general, it must see that no money is paid out for which we have not received full value in goods or services. More particularly, we wish to know

2. That raw materials and merchandise were bought at the market, in good condition,

3. That quantities paid for were actually received, and

4. That payments for capital and expense items were properly authorized.

As is common practice, all purchases must be initiated by a purchase requisition sent from the department requiring the goods to the purchasing department. The vendor's invoice, when received, must agree with the specifications on the requisition. All deliveries are made to a receiver, and the quantities shown on his report must be the same as charged by the vendor. Our method of audit is as follows:

1. The auditor examines and observes in detail the operations of the purchasing, accounts payable, and receiving departments, in order to appraise compliance with system, efficiency of personnel, and whether the present system is suited to actual conditions and requirements.

At receiving points he will try particularly to determine by observation and questioning the extent to which incoming goods are conscientiously counted, weighed, examined, and recorded.

2. All desks, files and correspondence are examined with a view to reporting on

a. neatness and orderliness,

b. answering of correspondence,

c. condition of the work, to make sure that orders are not being delayed.

3. Incoming correspondence goes to the auditor for several days.

4. The files of unfilled requisitions are checked to see which vendors are late with invoices. Vendors' invoices on hand are also checked to see if there has been faulty receiving or requisitioning on our part.

5. We have both a voucher system and an accounts payable ledger system, the use of either depending on local conditions. If the latter is used, the ledgers are checked in detail for balances, adjustment, and age of accounts. Postings are tested, and vendors' statements are checked against the ledger accounts. There are always certain vendors' statements on hand; in addition, the auditor requests verification statements from a group of vendors.

6. A representative number of files of vouchers are examined in detail and checked to the controls. In his examination of the vouchers the auditor looks for:

a. Completeness of the voucher, that is, there must be our requisition, vendor's invoice, and our receiving records. All must agree. If the delivery of goods is a complicated one, there must be on file all documents necessary to show that we received exactly what we paid for. There is no rule of thumb; the auditor must know what is required in every case.

b. The auditor passes judgment on neatness. We do not tolerate careless or untidy work at any point.

c. Complete authorization must be evidenced by the signatures on the vouchers.

d. There must be complete evidence by signatures that quantities, specifications, prices, and arithmetic have been checked. Arithmetic is tested by an audit clerk.

e. If necessary, competitive prices must be obtained.

f. Date of the voucher is noted. We do not tolerate late vouchering, and we insist on prompt payment to our vendors.

7. Besides checking ledgers and vouchers, all additions of listings and controls are checked by comptometer operators and the totals verified to the controlling accounts.

In summary, we believe that our method of internal audit relating to accounts payable is the best we can devise to guard against fraud and important errors. We do not pretend that it is very effective in preventing an arrangement between a vendor and one of our buyers to shade a price in the vendor's favour. We buy in very large quantities and it is difficult to detect a purchase that is a fraction of a cent a pound too high.

We believe that our internal audit has kept these departments operating in orderly fashion, with minimum staff, and has ensured that the work of purchasing and vouchering is always up to date.

Accounts Receivable

Every retail butcher and grocer in Canada is our customer, plus thousands of other businesses and institutions that use our products and by-products. Our salesmen blanket the country, and they collect most of the accounts. We have twenty-five sales offices, each with its own accounts receivable ledgers, which are in charge of a credit manager. The individual control of accounts is at the local office, but policy is set at head office, and overdue reports are sent to head office once a month. For the most part, the meat packing industry allows a week's

credit only, and none of the large companies will allow much delinquency.

The internal audit department is confronted with the following:

1. It must verify, at widely scattered points, that the accounts due from customers are represented in the correct amounts in the ledgers.

2. Because accounts are paid to the salesmen, the auditors must be alert to the possibility of the withholding of collections.

3. The auditor must appraise the efficiency of local credit management, and of the clerical work in the accounts receivable department.

4. The accuracy of reports to head office must be verified.

With these requirements in mind, our auditors usually visit accounts receivable departments on a surprise basis and take possession of one or more ledgers. The accounts are checked in detail to a current trial balance, or the auditor makes his own. All accounts are proven for adjustment, and postings are tested. The age of the accounts is checked to the latest overdue report, or the auditor compiles his own overdue report if his visit is not at or near the end of the month.

The files, records, and routine of the department are closely examined for evidence of inefficiency in any way. It is our rule in accounts receivable work, that all posting and balancing must be completed each day, and the auditor reports any failure to observe this rule.

Verification statements are mailed to all the customers of certain salesmen. Usually the writing of these statements is done by local clerical staff but the auditor must check them to the ledgers and supervise their mailing. Occasionally an auditor will personally call on a number of customers to verify their accounts at which time he will naturally be interested in the customers' reactions to our products and service.

After completion of the audit, the auditor's report covers:

1. His opinion of the local credit management, supported by comment on individual accounts.

2. An appraisal of the mechanical efficiency of the department and the personnel.

3. Comment on any errors or omissions found during the audit.

4. Manipulation of collections. If such a case is found, a special report is made.

The main idea, of course, is to present to the executives and the general credit manager a report on the department that will give them all the facts that they would seek if they made a personal visit.

Inventories

The extent of inventory verification by public accountants throughout the country may vary widely, but in our company there are no qualifications to the check required from the internal audit department. Every time an auditor visits one of our locations he must check the inventory completely, and at the end of the financial year a complete check is made throughout the company under the supervision of the internal audit department. Emphasis is laid on this because of the perishability of many of our products, the danger of theft, and the possibility of manipulation of inventory figures to cover operating losses. The last is a serious matter because of our policy of decentralized operations, and of our practice of weekly profit and loss statements. On occasion a department manager may think that, by inventory manipulation, he can cover up a bad week, and then regain the lost ground in the following week.

All this responsibility presupposes that our internal auditors are familiar with our products, and limits recruits for the department to men of some experience.

At branch warehouses, the auditor checks all of the inventory at one time.

At large packing plants, the inventory is usually checked in sections.

Whenever possible, the auditor or auditors will do everything themselves. But if the inventory is too large, local men are enlisted who have no connection with the inventory to be checked. They are given written instructions and are required to sign a certificate as to their check.

The method of check is to visit every room in the building and record everything found there. The inventory sheets are then priced, totaled, and compared to book records for both weight and value. The auditor always takes one or more men with him who are familiar with the inventory to assist him in locating, moving, piling, counting, or weighing the product.

Special attention is paid to obsolete, damaged or inferior goods.

Checking

It goes without saying that the book records will also be checked to make sure they are accurate. The auditor must also be on his guard that all product received has been vouchered and that there are no large fictitious sales just prior to his visit.

With our system of weekly results, it is often possible to check the inventory at the close of the week's business, and the book records will then be cut off in a normal way. In any case, it is not difficult, if in the middle of a week, to post purchases and sales up to the time of inventory check.

There is nothing very complicated about the auditor's report on this task. Since we handle many products subject to shrinkage there are always a number of discrepancies. The auditor reports only those he feels to be abnormal. Where the discrepancies are abnormal, the auditor tries to determine the reasons, which may be due to clerical error, poor operating, manipulation, or theft. This is the most difficult part of the assignment, and often means hours of unrewarded work.

The auditor's report also deals with the handling of the stock, adequacy and condition of space, slow-moving lines, and condition of product.

Special Assignments

The first illustration in this section concerns an examination of accounts, and survey of operations, of a conversion plant of a heavy-industry corporation. The parent corporation maintains a regular internal audit department. Its program, however, did not cover this conversion plant, as its character and relationship were not permanent.

As stated in the report to the chief auditor, this assignment was to determine:

1. Whether the accounts of the conversion plant appear fairly to reflect all of its financial transactions since inception of its operations, and its current financial position;
2. Whether its property accountability records appear fairly to reflect the kinds and quantities of property for which it must account, and whether the quantities which the records show as on hand are in fact on hand;
3. Whether its accounting procedures and system of general accounting control appear to be adequate, and
4. Whether the status of its affairs and the progress of its work in general appear to be satisfactory.

The audit report in this case covered forty-eight pages, but it is condensed in the following pages to show the scope, methods and results of the assignment.

The auditors were given a free hand to pursue whatever methods they considered necessary to achieve their purpose. This audit differed from a routine assignment in that the auditing department had never visited the plant before, and, because it was not included in the audit

program, there was no laid-down procedure as a guide. Further the auditors were not on familiar company ground, and therefore had to proceed with caution and tact in their examinations and conversations.

The senior in charge states that his staff

> examined the trial balance, supporting schedules and statement of contract documentation. They reviewed the accounting procedures and system of internal control, and, without making a detailed audit, examined or tested accounting, property accountability and other records in a manner and to an extent deemed necessary; in addition, inspected the physical facilities and arrangement of the plant, reviewed its mode of operation, and discussed the status of its affairs and the progress of its work with its management and supervisory personnel.

Important Points Disclosed

The report disclosed a number of important points:

1. The plan of organization approved by the controlling company had not been put into effect, with the result that some activities were organized in a manner never approved by proper authority.
2. Liaison between the conversion plant and head office had been unsatisfactory.
3. No person had been designated for the maintenance and further development of the plant's standard practice manual.
4. Responsibility for certain stores was to have been transferred. This had not been done.
5. Surplus stocks of contract material appeared to be excessive.
6. Control of material quantities sent to sub-contractors appeared to be inadequate.
7. Certain accountability records of importance had not been completed on schedule.
8. Periodic physical inventories had not been complete.
9. Physical inventories had not been taken by disinterested persons.
10. Internal check in the payroll department was inadequate.
11. Stockrooms did not maintain adequate records to show the definite location of all parts and materials stored.

Enumeration of these findings should illustrate the value to management of this type of assignment. A few trained men, in a few weeks, had been able to give to the home office a very detailed picture of operations at this plant. It is almost as if the executive office could see into the operations with a long-range telescope. The situation as it exists is set forth clearly for managerial review and action. In the forty-eight pages of the report all necessary information is given to support the summarized findings.

The report is divided into sections, each section giving the findings for a particular area of responsibility at the head office. For example, one part is directed to the organization control department, another to the chief accountant, and another to the material and procurement department.

The chief auditor was responsible for seeing that the report went to every administration and supervisory person concerned, in order that the full value of the report would be realized.

A Check of Truck Deliveries

Returning to our own industry, the next case history deals with a check of truck deliveries. At this point it might be well to explain the origin of special assignments. In our company, the head of the internal audit department reports through the assistant treasurer to the (financial) vice-president. Above the latter is the president, with whom there is not much direct contact. Special assignments are handed to the internal audit department by all three executives, or may be initiated by the head of the audit department. In actual practice, most of them originate with the vice-president and assistant treasurer.

To proceed with this example, good delivery service is essential in the meat industry. Every shipment from a plant or warehouse contains food that is highly perishable. If it is not properly packaged and handled, if it is not delivered promptly under correct temperature conditions, important losses may result to the company and to the community's food supply. Moreover, the fierce competition in the meat industry makes it necessary that our delivery service be of the best. A still further reason for the checking of our deliveries is the possibility of theft, effected by collusion between plant workers and truck drivers.

The daily responsibility of the foregoing rests, of course, with the superintendents and foremen in charge of shipping and deliveries. They should maintain high standards and keep alert for misdemeanors. It is human nature, however, to live with an operation and not detect the signs of deterioration. Inefficiencies creep in unnoticed by those charged with day-to-day supervision. The following episode will illustrate this.

On this assignment it was decided to check the deliveries made from eight trucks going to various points within a radius of 100 miles. These trucks are loaded in the night and begin delivery at their earliest point of call as soon as business opens for the day.

Secrecy Essential

Four internal auditors and four senior men from the general office were selected. Without any previous warning they were given sealed instructions at 5:00 o'clock in the afternoon, which ordered them to report to the audit department office at 3:00 o'clock in the morning. This secrecy is necessary to prevent any hint of the check leaking out to the shipping and trucking departments. Any such warning would destroy the usefulness of a check of this kind.

This assignment illustrates one method of enlarging the scope of a small internal audit department. That is, four men from the general office were used in the assignment, since it was of such a nature that specialized training was not necessary, and very explicit written instructions were given. The same principle can be applied to other special assignments. It is necessary, of course, to carry the support of local management in such cases, as we would not think of summarily drafting men without a previous understanding with their superiors.

The eight trucks were boarded by the auditors just as they pulled away from the plant. The auditors presented a letter of authorization to the drivers and requested possession of all delivery documents. At each call, the auditor checked the goods against the shipping bills, examined the condition of the goods, and generally observed the whole delivery process. Without stressing that there was anything special about the visit, customers were invited in friendly fashion to give their opinion of our goods and service.

Report

A written report was made by each man upon return to the office, and these reports were summarized by the audit department. Reports and summary were sent to management and all operating departments concerned. The summary of this particular check was briefly as follows:

1. Two items on the trucks were not covered by invoices, and one item was invoiced but missing from the truck. These were fully investigated by the internal audit department, which found no evidence of dishonesty but did find errors and weaknesses in loading and checking.
2. Some trucks were loaded, pulled up on the road outside the plant, and left for as long as an hour without guard.
3. Trucks were left at sub-depots, awaiting drivers, without guard.
4. There were some delays between

completion of the loading and departure of truck. This resulted in late deliveries and product deterioration.

5. Due to improper packaging, there was damage to other goods from certain meat products which must be shipped in a wet condition.

6. Heavy goods were being loaded on top of lighter packages.

7. Cartons were improperly stitched, due to failure to follow instructions.

8. The white coats worn by some drivers were not clean enough, and some needed repair.

9. One truck was badly overloaded.

10. The time schedule for loading and dispatching needed revision.

As previously stated, the report of these conditions was sent to all management personnel concerned, with the result that steps were taken to correct the weaknesses revealed. While these conditions may have come to light one by one, an investigation of this kind was able to focus attention quickly on all the shortcomings of the whole operation.

Fraud and Theft

The final section of this paper deals with a part of the internal auditor's work that is always unpleasant but nonetheless very important, the investigation of fraud and theft. There is a strong tendency among internal auditors today to play down their work in this regard, and to concentrate their efforts and ideas on other services to management. Such a trend is all to the good, and the Institute of Internal Auditors is doing much to encourage it. Nevertheless, an internal auditor will be faced with work on defalcations, and for that work he should be well trained indeed, because it is very difficult and very specialized. The following examples will indicate some of the special techniques that are necessary.

It might be appropriate to remark at this point that inexperience in such investigations, and consequent lack of prompt action, has often resulted in failure to find out all the facts, inability to recover all or part of the loss, and considerable waste of time. Nothing can play havoc with an audit program so much as a defalcation that takes weeks of investigation, and therefore the internal auditor should know exactly what to do, and how to do it quickly.

Withholding of Collections

One of the common misdemeanors is the withholding of collections by salesmen. They are usually detected by sending verification statements to customers, or by intelligently examining accounts. The following will illustrate both.

During the audit of one of our plants, our man sent out verifications to the customers on several sales territories, as soon as he arrived in that particular city. Several days later one of the verifications was returned with a notation that a small item was not in order. The territory concerned covered a number of small towns the centre of which was about 50 miles from the plant.

The auditor decided to investigate at once, and on the spot, even though there might only be a mistake involved. Taking the local office manager with him, he drove to see this particular customer and found his suspicions were confirmed. The customer's receipts showed that payments had been made to the salesman and had not been reported by him.

With one concrete example in his possession, the auditor had to decide whether to check further customers, or whether to question the salesman first. He decided on the latter, hoping that the salesman might tell him all the facts and save some time, even though the salesman's story would have to be verified later.

As is all too usual, and all too foolish, the salesman denied that there were any further items. He made the excuse that he had temporarily borrowed the amount already detected and intended to turn it

in the next day. In denying further misappropriations, it is possible he thought he could cover up before the auditor completed his check.

The auditor immediately began calling on the customers close at hand. The very first call disclosed a second shortage. For the next two days our man called personally on all accounts which might bear checking in this way, and completed the check by telephone and mail. Several more shortages turned up. Fortunately the whole amount was not large, but could easily have been greater if the salesman had not been caught early in the game.

On another occasion, the examination of an accounts receivable ledger disclosed one territory on which the number of overdue accounts seemed high. The auditor's suspicions were aroused, and he talked them over with the credit manager and the sales manager. The former agreed with the auditor, but the sales manager discounted the idea because of the long service and good record of the salesman concerned. He said the man was just doing a poor collecting job.

The auditor was not satisfied and went to his superior. The chief auditor decided that the suspicion was strong enough to warrant an investigation. He despatched an auditor by train that night to the city concerned, about 200 miles away. The next morning he had a telephone call from the auditor saying that the salesman had been contacted on arrival and had at once confessed to a shortage of approximately a thousand dollars. He gave the auditor a list of accounts and amounts involved. The auditor then drove with the salesman to see every customer. In this case, an unusual one, it was verified that the salesman had given the full facts when first challenged.

Conclusions To Be Drawn

The important conclusions to be drawn from these cases are, first, that it pays to investigate promptly even slight evidence or suspicion of defalcation. Second, the investigation must be carried out quickly and completely, before there is a chance to cover up. In many cases of this kind, the auditor will be working alone and, therefore, must make the decision as to course of action.

In this type of assignment, the internal auditor must be able to make friends with the company's customers so that he will be given free access to all records necessary. He should not, however, discuss the matter but leave the impression that the check is routine. A knowledge of retail accounting is helpful, so that the auditor can get quickly to the essential documents and information he needs.

In another case several years ago, two of our internal audit staff were covering a routine audit at a small plant. On such an audit all departments are examined fairly closely, as the local staff is small and it is difficult to build up much internal check by sub-division of duties. In other words, various individuals have considerable local responsibility. An example that fits into this case is that the manager of the dairy products department, or produce manager, not only did the buying and selling of his particular lines but had some accounting duties in connection with inventories and weekly profit and loss statements. This particular man was a trusted senior employee of many years' service.

In the examination of this department, part of the inventory was taken and found correct. More inventory was to be checked a few days later. In the interval inventory prices of butter were compared from week to week, and were found to have have been increased a quarter of a cent a pound for no apparent reason except, to the suspicious mind of the auditor, to make the operating results look a little better in some weeks. There

were also some mistakes in the storage records.

The produce manager's explanations of this were vague, and the auditor deliberately gave out a broad hint that he was going to check some more inventory the next morning.

Late that night the local plant manager reported to the auditor that the produce manager had confessed to a shortage of $1,800.00 in inventory. He claimed he had raised inventory prices and quantities to cover trading losses, hoping to redeem them later.

Next morning the auditors took the following steps:

1. The inventory was completely checked. It consisted of merchandise and supplies stored at the plant and several outside storages. The shortage proved to be in the neighborhood of $10,000.

2. Examination of vouchers and accounts revealed forged receiving and purchase vouchers, storage vouchers abstracted from the mail and destroyed, and fictitious purchases and sales with outsiders. Shortages were covered up by forged verification statements, and by assistance from a storage clerk.

Catching the Coadjutors

It was quickly apparent that it was most important to find out the receivers of the stolen goods. The fictitious sales supplied the names of two wholesalers, and these were visited at once by both auditors, before the man involved could say much to them, and before they could think up good stories. Both auditors went, as two witnesses are better than one.

The wholesalers were caught off balance. At one place the auditors demanded to see the books. The man concerned was frightened and had not had time to see his lawyer. Without realizing he could refuse, he brought out his books and the auditors found valuable evidence therein. The other man was visited in the same hour. He, too, was bluffed into showing records and gave considerable verbal information which was promptly written down by the auditors.

As was to be expected, both men immediately sought lawyers, but the damage had been done so far as they were concerned. The auditors had made the right decision in hastening to see them within hours of finding traces of collusion with outsiders.

The next steps were long and painstaking, that of examining records and of questioning suspects and others. This tedious work is often avoided by investigators, but we consider it very necessary. By this means we try to build up a factual story of the misappropriation, and we try to obtain the maximum of documentary evidence. This latter is very useful in court, if necessary, and often leads to admissions by the person concerned when confronted with it. Further, the internal auditor must always think of trying to recover the amount stolen.

Defalcations of the kind illustrated are seldom easy to trace, and this was no exception. When we were finished we were not sure that we had uncovered the full extent of the thefts, and we were able to trace only a portion of the stolen goods. For the most part, we could tell when the shortages occurred and the method of covering them up, but we were unable to find where most of the goods went.

Because of lack of complete evidence from the files and from the men involved, our auditors undertook a very thorough cross-examination of every person, in our employ or otherwise, who had associated with the malefactor. This took several weeks, because the same ground was covered several times with the same people. This persistence was finally rewarded when a woman remembered visiting a

certain bank with the wife of the suspected man. That minor item enabled our men to locate several bank accounts, recover some of the money and obtain additional evidence.

The methods used to escape detection in this case were interesting. Some of them were simple, but were possible because of the carelessness of other employees.

1. Vouchers from storage companies were abstracted from the mail and, therefore, not posted.

2. Inventories and storage records in this small plant were in the control of the guilty man. He falsified them as he saw fit.

3. Independent checks of the inventories were circumvented by false verification statements, withholding of purchase and receiving vouchers, fictitious sales, and sheer carelessness of some checkers.

4. There was collusion with outside persons in the case of false verification statements and fictitious purchases and sales.

5. The bank records revealed the payment of bribes by certain wholesalers to invoice one grade of goods, but deliver an inferior grade.

It will be obvious that we took immediate steps to plug all the loopholes thus revealed, and the systems at all other plants were examined for similar weaknesses. The audit had the further result that a portion of the loss was recovered, but not all of it. The evidence collected was sufficient to bring all concerned into court.

Conclusion

The following qualifications appear to be those most needed by an internal auditor:

First, he must be an experienced accountant. Many graduates of good accounting and business courses in schools and universities want to step at once into the internal audit department. Possibly the glamour appeals to them. The recent graduate will do better in the long run by first obtaining considerable experience in clerical, accounting, and operating positions. This seems especially true when thinking of a job like internal auditing, which deals mostly with the things that go wrong, not with those that go right.

Second, only a man who can think quickly on the spot and is willing to make decisions on his own will ever be a good internal auditor.

Persistence and patience are other necessary qualifications, as illustrated in several of the cases above.

Finally, the utmost ability to be tactful, diplomatic and personable is needed. An auditor spends much of his time interviewing and questioning all kinds of people. He must get results without antagonizing, and without saying one word that might be harmful to himself, his department, or his company.

The Consolidated Balance Sheet of Affiliated Companies

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Illustrations of a logical method of preparation with minimum working papers

FOR PRACTICAL PURPOSES, in the offices of professional accountants, detailed columnar working sheets are essential. Under examination conditions, however, some means of more direct consolidation will be useful. The method now to be illustrated in a few carefully graded examples is based on a logical appreciation of the objects to be gained and has for many years been successfully used by the writer and his students.

The following graded illustrations can be regarded as only a brief introduction to the complexities of consolidation. But if the student works carefully through each example it is hoped that he will gain a clear idea of the basic principles involved.

ILLUSTRATION I

X, Ltd. buys all the shares in Y, Ltd., on 31st December, 1948. The balance sheets on this date, immediately after the purchase, are as follows:

X, Ltd.

Investment in Y, Ltd.		
10,000 shares at cost		$270,000
Other assets		500,000
		770,000
Creditors		120,000
Share Capital	500,000	
General Reserve	100,000	
Surplus	50,000	650,000
		770,000

Y, Ltd.

Assets		$300,000
Creditors		30,000

Share Capital:		
10,000 shares of	$25,250,000	
Surplus	20,000	
		270,000
		300,000

Solution

In this simplest of examples the consolidated balance sheet immediately results from merging the two balance sheets and cancelling X, Ltd.'s investment against the share capital and surplus of Y, Ltd. This is a case of a 100% holding, where the amount paid exactly equals the book value of the shares of the subsidiary, and consolidation is taking place at the time of acquisition, so that there is no possible complication.

CONSOLIDATED BALANCE SHEET OF X LTD. AND Y LTD.
AT 31st DECEMBER, 1948.

Assets:		
X Ltd.		$500,000
Y Ltd.		300,000
		$800,000
Creditors:		
X Ltd.	120,000	
Y Ltd.	30,000	150,000
Share capital: X Ltd.	500,000	
General reserve: X Ltd.	100,000	
Surplus: X Ltd.	50,000	650,000
		$800,000

The one important point of principle immediately to be noted from even this simple illustration is that the share capital, reserves and surplus of the subsidiary, *as at the date of acquisition by the holding company,* do not appear as such on the consolidated balance sheet.

ILLUSTRATION 2

Consolidation as at date of acquisition, where the inter company holding is less than 100%.

P Ltd. buys 75% of the common stock of Q Ltd. on 31st December, 1947. The balance sheets immediately after acquisition are as follows:

P Ltd.

Investment in Q Ltd. at cost		$280,000
Other assets		60,000
		$340,000
Creditors		85,000
Capital Stock	220,000	
Surplus	35,000	255,000
		$340,000

Q Ltd.

Assets		$460,000
Creditors		20,000
Capital Stock		
Preferred Shares	100,000	
Common Shares of $25 each	300,000	
General Reserve	30,000	
Surplus	10,000	440,000
		$460,000

Note: The preferred shares have no voting power or right to share in surplus profits on a winding up. There are no arrears of preferred dividend.

Procedure for consolidation

1. Calculate the amount, if any, by which the purchase price differs from the book value of the shareholding acquired in the subsidiary.

Book value of capital stock at date of acquisition, as detailed on Q Ltd.'s balance sheet	$440,000
Less: Portion attributable to preferred shares	100,000
Book value of common shares at date of acquisition	340,000
Proportion attributable to P Ltd.'s holding: 75%	255,000
Paid by P Ltd. on acquisition	280,000
Amount paid for goodwill by P Ltd., additional to any which may be included in the assets on Q Ltd.'s balance sheet	25,000

N.B. This assumes that Q Ltd.'s assets are stated on its balance sheet at the agreed values on the basis of which P Ltd. acquired its holding.

2. Redraft the balance sheet of Q Ltd. as follows, ready for consolidation:

Q Ltd.

Assets	$ 460,000
Goodwill	25,000
	$ 485,000

Creditors			20,000
Interest of shareholders outside the combine:			
Preferred shares		100,000	
Common shares:			
Par value, ¼	75,000		
Gen. Reserve ¼	7,500		
Surplus ¼	2,500	85,000	185,000
Interest of P Ltd.			280,000
			$ 485,000

3. The balance sheet of P Ltd. can now immediately be merged with the redrafted balance sheet of Q Ltd., omitting the equal and opposite items of $280,000, to give the following:

CONSOLIDATED BALANCE SHEET OF P LTD. AND Q LTD.
AT 31st DECEMBER, 1947

Goodwill, Q Ltd.		$ 25,000
Other assets: P Ltd.		60,000
Q Ltd.		460,000
		$ 545,000
Creditors: P Ltd.	$ 85,000	
Q Ltd.	20,000	105,000
Interest of minority shareholders of Q Ltd.		
Preferred	100,000	
Common	85,000	185,000
Capital Stock: P Ltd.	220,000	
Surplus: P Ltd.	35,000	255,000
		$ 545,000

Two essential points in the general methods of procedure may now be emphasized:

A. The only part of the capital stock, reserve and surplus of the subsidiary, *as at the date of acquisition of the holding company's interest,* that will be included in the consolidated balance sheet is that which belongs to *shareholders outside the combine.*

B. Before the consolidated balance sheet can be prepared it is essential to calculate the difference between the amount paid for the holding company's shares in the subsidiary and the equity value of those shares, as reflected by the subsidiary's balance sheet. This value is found by deducting from the aggregate of capital stock, free reserves and surplus, at the date of acquisition, that portion which belongs to outside shareholders, whether preferred or common. If the sum paid exceeds this value it may be entered on the consolidated balance sheet as goodwill or cost of control, unless any part of it is attributable to the

valuation by the holding company of any asset of the subsidiary at a figure greater than its book value. If the sum paid is less, then a corresponding capital reserve will be inserted on the liabilities side of the consolidated balance sheet, or deducted from any goodwill which may be included among the assets of the holding company or the subsidiary.

The logic of this simple method of consolidation at the date of acquisition of the inter company holding is that, if the subsidiary's balance sheet is redrafted to replace capital stock, reserves and surplus by credits which apportion the total of these items between (a) the outside shareholders and (b) the holding company, then, if the goodwill or capital reserve from B. above is duly entered, the credit to the holding company is bound to be exactly equal and opposite to the investment in the subsidiary on the holding company's balance sheet. On consolidation of the two balance sheets these two items will therefore disappear.

Thus far the illustrations have been particularly simple because they have dealt only with consolidation at the date of acquisition. The next illustration has a period of some years between the two dates.

ILLUSTRATION 3

A LTD.

BALANCE SHEET AS AT JUNE 30, 1948

Investment in B Ltd.		
20,000 shares of common stock at cost, acquired 1/7/44		$ 280,000
Other assets		140,000
		$ 420,000
Creditors		$ 40,000
Capital stock: 30,000 common shares of $10 each	$ 300,000	
Reserve	60,000	
Surplus	20,000	
		380,000
		$ 420,000

B LTD.

BALANCE SHEET AS AT JUNE 30, 1948

Assets			$ 342,000
Creditors			$ 10,000
Capital Stock:			
500 5% Preferred Shares of $50 each		$ 25,000	
25,000 Common Shares of $10 each		250,000	
Reserve, 1/7/44	$ 20,000		
Additions to date	12,000	32,000	
Surplus, 1/7/44	10,000		
Add: Profits, less appropriations to date	15,000	25,000	332,000
			$ 342,000

Note: The preferred shares have no voting power or right to share in surplus profits on a winding up. There are no arrears of preferred dividend and there has been no issue of shares since July 1, 1944.

Procedure for consolidation

1. Calculation of goodwill or capital reserve:

Net worth of capital stock, 1/7/44: B Ltd.	
Preferred Shares: par value	$ 25,000
Common Shares: par value	250,000
Reserve, 1/7/44	20,000
Surplus, 1/7/44	10,000
	305,000
Less: Attributable to holders of preferred stock	25,000
Amount attributable to holders of common stock	280,000
Less: 20% attributable to outside holders of common stock	56,000
Book value of shares acquired by A Ltd., 1/7/44	224,000
Amount paid by A Ltd., 1/7/44	280,000
Payment for goodwill or cost of control	$ 56,000

Note that the fact that consolidation is taking place four years after acquisition makes no difference. The reserves and surplus taken into account for this calculation must always be *as at date of acquisition.*

2. Redrafting the balance sheet of B Ltd. for consolidation, following the rules already stated:

B Ltd.

Goodwill paid for by A Ltd.				$ 56,000
Other assets				342,000
				$ 398,000
Creditors				10,000
Interest of outside shareholders:				
Preferred			$ 25,000	
Common: Par value	20%	$ 50,000		
Reserve	20%	6,400		
Surplus	20%	5,000	61,400	86,400
Interest of A Ltd.				
Paid 1/7/44			280,000	
Share of profits left in the business since 1/7/44:				
Reserve: 80% of $12,000			9,600	
Surplus: 80% of $15,000			12,000	301,600
				$ 398,000

3. Merging the above redrafted balance sheet with that of A Ltd.

CONSOLIDATED BALANCE SHEET OF A LTD. AND B LTD.
AS AT JUNE 30, 1948

Goodwill, B Ltd.		$ 56,000
Other assets: A Ltd.		140,000
B Ltd.		342,000
		$ 538,000
Creditors: A Ltd.	$ 40,000	
B Ltd.	10,000	50,000
Interest of outside shareholders of B Ltd.		
Preferred	25,000	
Common	61,400	86,400
Capital Stock: A Ltd.		300,000
Reserve: A Ltd. 30/6/48	60,000	
Add: A Ltd's share of increase in B. Ltd.'s reserve since 1/7/44	9,600	69,600
Surplus: A Ltd., 30/6/48	20,000	
Add: A Ltd.'s share of increase in B Ltd.'s surplus, since 1/7/44	12,000	32,000
		$ 538,000

Arising out of this illustration of consolidation some time after the date of acquisition of the inter-company holding, point A above, in the methods of procedure, can be re-stated and amplified as follows:

A. The only part of the capital stock, reserve and surplus of the subsidiary to be included in the consolidated balance sheet will be

(*a*) the interest of outside shareholders in the *whole* of such capital stock, reserve and surplus, whether created before or after acquisition, and (*b*) the interest of the holding company in such portions of these items as have been created *since the date of that acquisition,* these portions being included as part of the reserves and surplus of the whole combine.

The reason for this rule is obvious, from the position as reflected in the redrafted balance sheet of B Ltd. The interest of A Ltd. comprises the $280,000 paid on acquisition, plus the 80% share in reserve and surplus increases, i.e. $9,600 and $12,000, respectively, since 1/7/44. The $280,000, which cancels out against the investment on the assets side of A Ltd.'s balance sheet and does not appear in the final consolidation, is made up of:

A Ltd.'s 80% share of B Ltd.'s common stock	$200,000
80% share of B Ltd.'s reserve, 1/7/44	16,000
80% share of B Ltd.'s surplus, 1/7/44	8,000
Goodwill as already calculated	56,000
	$280,000

Thus A Ltd.'s share of the subsidiary's reserve and surplus, in so far as they existed at the time of acquisition, is part of the purchase price and cancels out, so that it never appears on the consolidated balance sheet. This rule is fundamental and must always be carefully observed. If the subsidiary's reserves or surplus have decreased since acquisition the holding company's proportion of such decreases will, of course, be deducted from its reserves or surplus on the consolidated balance sheet.

The essential principles have now been stated and the next illustration will take a typical examination problem, introducing various practical features:

Born at Durban, South Africa, Professor Byrd, M.A., B.Sc. (Econ.), returned to Natal in 1929 as lecturer in accounting and auditing at Natal University College, having received his early and college education in England. He was Dean of the Faculty of Commerce and Administration at Natal University College on his appointment as Professor of Accounting at McGill University in 1949. He is a member of the Natal Society of Accountants and of the Institute of Chartered Accountants in England and Wales.

ILLUSTRATION 4

The balance sheets of Holders Ltd. and Sub Ltd., at December 31, 1948, are as follows:

HOLDERS LTD.

Goodwill		$ 40,000
Investment in Sub Ltd.: 30,000 common shares at cost		250,000
Debentures in Sub Ltd., at par		60,000
Inventory of merchandise		80,000
Bills receivable		10,000
Other assets		90,000
		$ 530,000
Creditors		50,000
Capital stock	$ 400,000	
Reserve	50,000	
Surplus	30,000	480,000
		$ 530,000

Note: Bills drawn on Sub Ltd. to the value of $8,000 have been discounted and are still outstanding.

Note: The investment in common stock of Sub Ltd. was made on January 1, 1948. Included in inventory of merchandise are goods valued at $50,000, at which price they were bought from Sub Ltd., who charged 25% on cost. Of these goods $30,000 worth, as charged by Sub Ltd., are still unpaid for at December 31, 1948.

SUB LTD.

Goodwill		$ 50,000
Debtors		80,000
Other assets		746,000
		$ 876,000
Creditors		30,000
Bills payable: Holders Ltd.		18,000
Debentures		62,000
Capital stock:		
5,000 5% preferred shares of $50	$ 250,000	
45,000 common shares of $10	450,000	700,000
Reserve, 1/1/48		20,000
Surplus, 31/12/48		46,000
		$ 876,000

Note: The preferred shares have priority for return of capital but no voting power and no interest in surplus profits on a winding up.

Analysis of the surplus balance of $46,000 on Sub Ltd.'s balance sheet reveals a profit for the year of $60,000 and payments of the following dividends during the year:
Preferred dividend of $6,250 for each of the half years to 31/12/47 and 30/6/48; final common dividend for 1947 $22,500; interim common dividend for 1948 $9,000.

Required: (i) Correction of any important error of principle in the accounting as reflected by the balance sheet of Holders Ltd.;

(ii) Consolidated balance sheet of the two companies as at 31st December, 1948.

Solution

1. The analysis of Sub Ltd.'s surplus indicates that Holders Ltd. must have received, during the year to December 31, 1948, since the acquisition of its shares in Sub Ltd., a final dividend of $15,000 (two-thirds of $22,500) applicable to its two-thirds holding, in respect of the year to December 31, 1947. The profits out of which this dividend was paid were obviously included in the purchase price of the shares on January 1, 1948, and the dividend cannot, therefore, properly be regarded as *income* to be credited to the profit and loss account of Holders Ltd., but as a refund of part of the purchase price of the shares. Correct accounting treatment would, therefore, have credited the $15,000 to the Investment in Sub Ltd. Since this item appears at cost, $250,000, on the balance sheet of Holders Ltd., the $15,000 has presumably been credited to Holders Ltd.'s Profit and Loss Account and is part of the $30,000 surplus. The balance sheet must, therefore, be corrected to show this surplus at $15,000 and Investment in Sub Ltd. at $235,000. It may be noted that the *Companies Act of 1948* in Great Britain has now prevented such dividend from pre-acquisition profits from being included in income in that country. While sound accounting practice in Canada will demand similar treatment, there is apparently nothing legally to prevent the crediting of such a dividend to profit and loss account with other dividend income, though any auditor would undoubtedly qualify his report to reveal the fact. It

is obvious that treatment such as that shown on Holders Ltd.'s balance sheet inflates both the investment and the profits of the company.

2. This error of principle having been rectified, the value of goodwill or capital reserve in connection with the acquisition of the holding in Sub Ltd. is found in the usual way.

Capital stock, Sub Ltd., 1/1/48		$700,000
Reserve, 1/1/48		20,000
Surplus, 1/1/48		30,000
		$750,000
Less: Due to preferred shareholders	$250,000	
Add: Preferred dividend, ½ year to 31/12/47	6,250	256,250
Net worth of common shares, 1/1/48		$493,750
Interest of Holders Ltd. — two-thirds		$329,167
Paid by Holders Ltd.		250,000
Capital reserve		$ 79,167

3. Having, in the earlier illustrations, seen the essentials of the method of consolidation by redrafting the balance sheet of the subsidiary, let us in this solution avoid the necessity for actual redrafting by drawing up essential schedules. This will enable us to proceed direct to the consolidated balance sheet.

(i) Bills payable, Holders Ltd., $18,000. Of these Holders Ltd. has discounted $8,000, which do not appear on its balance sheet. Only the balance of $10,000 will cancel out on consolidation. No note as to any contingent liability will appear on the consolidated balance sheet.

(ii) $60,000 debentures will cancel out against the holding of Holders Ltd.

(iii) Interest of outside shareholders:

Preferred: Par value	$ 250,000	
Dividend accrued, ½ year to 31/12/48	6,250	$ 256,250
Common: Par value, one-third	150,000	
Reserve, one-third	6,667	
Surplus, one-third $\frac{46{,}000 - 6{,}250 \text{ pref. div.}}{3}$	13,250	$ 169,917

(see note (*a*) below)

(iv) Inventory suspense: two-thirds of 20% of $50,000 .... $ 6,667

(to be deducted from profit of Sub Ltd. and inventory of Holders Ltd. in consolidated balance sheet)
(see note (*b*) below)

(v) Interest of Holders Ltd.

Paid 1/1/48			$ 250,000
Less: Dividend from pre-acquisition profits			15,000
			235,000
Profit of Sub Ltd. since 1/1/48		$ 60,000	
Less: Appropriations therefrom:			
Pref. divs. 1948	$ 12,500		
Common div. interim, 1948	9,000	21,500	
		38,500	
Two-thirds		25,666	
Less: Inventory adjustment (see (iv) above)		6,667	18,999
			$ 253,999

Note: The $235,000 will cancel out on consolidation.

(vi) $30,000 due to Sub Ltd. will be deducted from creditors of Holders Ltd. and debtors of Sub Ltd.

Important Notes

(*a*) In calculating the liability to outside common shareholders it must not be forgotten that the surplus of $46,000 on Sub Ltd.'s balance sheet has already been reduced by provision and credit to preferred shareholders of the half year's dividend of $6,250, accrued to 31/12/48. It must, however, be noted that, if Sub Ltd.'s balance sheet showed no surplus or reserves this accrued dividend could not be provided for, unless it were specifically stated that the shares were preferred both as to capital and arrears of dividend in a liquidation. In making the provision here the credit to preferred shareholders is made, whether or not the dividend has been declared by directors, because we are simply dividing the company's funds between its various owners, preferred and common, not as a current liability but to reflect ownership.

(*b*) The question notes that the inventory of merchandise on the balance sheet of Holders Ltd. includes $50,000 worth at the price charged by Sub Ltd. i.e. 25% on cost, or 20% of the $50,000, which is $10,000. Now Holders Ltd., as a two-thirds common shareholder of Sub Ltd., becomes entitled to two-thirds of this profit i.e. $6,667. From the point of view of the whole combine this is an unrealised profit, but this does not apply to the one-third share of the outside shareholders of Sub Ltd. Consequently, in the final consolidated balance sheet, adjustment must be made for this. Holders Ltd.'s share of Sub Ltd.'s profit since acquisition, as calculated in (b) above, is thus reduced by $6,667 and, since the inflated inventory is on the balance sheet of Holders Ltd., this amount of $6,667 must be deducted from such inventory in the final consolidation, thus reducing it to cost. It should be noted that, had the transaction been the other way round, Sub Ltd. having bought the goods from Holders Ltd. at a profit to the latter, exactly the same amount of unrealised profit would have had to be eliminated on consolidation. Holders Ltd. would have regarded itself as, in effect, selling the goods to the one-third outside shareholders of Sub Ltd. and to itself as two-thirds shareholder. Two-thirds of the profit would have been unrealised, i.e. $6,667, but in this case the inventory of Sub Ltd. would have been inflated to this extent. The adjustment, in the final consolidation, would have been by deduction of $6,667 from the profit of Holders Ltd. and the inventory of Sub Ltd., with the same final effect as in the present case.

4. Having careful regard to each of the points in 3, the final consolidation is effected direct, as follows:

CONSOLIDATED BALANCE SHEET OF HOLDERS LTD. AND SUB LTD.
AS AT DECEMBER 31, 1948

Other assets: Holders Ltd.			$ 90,000
Sub Ltd.			746,000
Debtors: Sub Ltd.			50,000
Inventory of merchandise:			
Holders Ltd.		$ 80,000	
Less: Unrealised profit		6,667	73,333
Goodwill: Holders Ltd.		40,000	
Less: Capital reserve, Sub Ltd.		29,167	10,833
			$ 970,166
Creditors: Holders Ltd.		50,000	
Less: Due to Sub Ltd.		30,000	
		20,000	
Creditors: Sub Ltd.		30,000	50,000
Bills payable (discounted by Holders Ltd.)			8,000
6% debentures: Sub Ltd.			2,000
Interest of outside shareholders of Sub Ltd.			
Preferred		256,250	
Common		169,917	426,167
Capital stock: Holders Ltd.		400,000	
Reserve: Holders Ltd.		50,000	
Surplus: Holders Ltd., as adjusted	15,000		
Sub Ltd. (since acquisition)	18,999	33,999	483,999
			$ 970,166

Arising out of this illustration a third point of procedure may now be added to A and B as already formulated:

C. The interest of the holding company in any subsidiary will be made up of the following: (i) the figure at which the investment in the subsidiary appears on the holding company's balance sheet, i.e. the original cost, less any dividends received by the holding company, since acquisition, out of any pre-acquisition profits of the subsidiary, plus (or minus) (ii) the holding company's share in any profits (or losses) of the subsidiary, *since acquisition of the holding company's interest,* less any appropriations made by the subsidiary *out of such profits.* The balance of the subsidiary's surplus, as at the date of acquisition, is ignored in arriving at the figure in (ii), as also any appropriations made by the subsidiary *out of this surplus.*

The technique adopted so far will now be applied to the solution of a much more difficult problem, involving a holding company and two subsidiaries, one of which itself holds shares in the other.

ILLUSTRATION 5

PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS, FINAL EXAMINATION, 1948, ACCOUNTING IV, QUESTION 2

The following are the post-closing trial balances of Co. 1, Co. 2 and Co. 3 (as at 31st March, 1948):

	Co. 1	Co. 2	Co. 3
Cash	$ 130,000	$ 40,000	$ 6,000
Inventories	212,000	166,000	40,000
Other current assets	220,000	148,000	44,000
Investments—Co. 2	384,000		116,000
Co. 3	160,000		
Securities at cost	40,000		28,000
Fixed assets, less depreciation	1,280,000	748,000	186,000
Total	$ 2,426,000	$ 1,102,000	$ 420,000
Credits			
Accounts payable and accrued expenses	$ 211,000	$ 107,500	$ 48,000
6% Bonds due 1st July, 1960	200,000		
First mortgage 6% bonds	400,000	200,000	80,000
6% cumulative preferred stock, par $100	400,000		80,000
Common stock, no par		482,500	
Common stock, par $100	740,000		160,000
Surplus, 1st April, 1947	245,000	222,000	60,000
Profits, year ending 31st March, 1948	230,000	90,000	8,000x
Total	$ 2,426,000	$ 1,102,000	$ 420,000

(x *denotes red figure*)

Investment in Co. 2 was made by Co. 1 as follows:

30th September, 1946, 23,200 shares no par common	$ 320,000
15th August, 1947, 4,200 shares no par common	64,000
	$ 384,000

Investment in Co. 3 was made by Co. 1 as follows:

1st April, 1940, 400 shares preferred	$ 34,000
1st April, 1941, 1,520 shares common	126,000
	$ 160,000

Investment in Co. 2 was made by Co. 3 as follows:

1st April, 1943, 5,250 shares common	$ 50,375
31st March, 1946, 5,250 shares common (par value of stock div.)*	65,625
	$ 116,000

*On 31st March, 1946, Co. 2 declared a stock dividend, transferring from earned surplus to capital stock the amount of $262,500, and issuing one share of common stock for each share outstanding as at that date.

The net worth of Co. 2 at the dates on which Cos. 1 and 3 purchased stock was:

	1 April 1943	30 Sept. 1946	15 Aug. 1947
Shares outstanding	21,000	42,000	42,000
Capital stock account	$ 220,000	$ 482,500	$ 482,500
Surplus	16,600	276,000	294,000
	$ 236,600	$ 758,500	$ 776,500

The net worth of Co. 3 at the dates on which Co. 1 purchased stock was:

	1 April 1940	1 April 1941
Preferred Stock	$ 80,000	$ 80,000
Common Stock	160,000	160,000
	240,000	240,000
Less: Deficit	30,800	26,000
Net worth	$ 209,200	$ 214,000

Co. 1 has taken up as income only the dividends received from the subsidiaries.

Preferred dividends of Co. 3 were in arrears from April 1, 1939 until March 31, 1944, when they were paid in full. All other preferred dividends were paid at the end of each fiscal year.

At March 31, 1948, the inventories of Co. 1 included the following:

Purchased from	Inventory Value	Gross Profit on Sales thereof to Co. 1
Co. 2	$40,000	$24,000
Co. 3	$28,000	$10,200

which are to be eliminated in total.

On 6th October, 1947, Co. 1 sold marketable securities (shown at cost of $25,200 on the books of Co. 1) to Co. 2 for $30,000, the market value at this date. On March 12, 1948, Co. 2 sold these securities at the market value of $27,500 to Co. 3. These profits and losses are to be eliminated in total.

Inter company accounts included in other current assets and accounts payable at March 31, 1948, were:

Owing to	Owing by	Amount
Co. 2	Co. 1	$60,000
Co. 3	Co. 1	5,000
Co. 2	Co. 3	6,000

Required: Consolidated work sheet of Co. 1 and its subsidiaries as at March 31, 1948, showing details of all eliminations and adjustments made.

Solution

Preliminary assumption: As no indication is given in the question it is assumed that the preferred stock of Co. 3 has

absolute priority, in a liquidation, over the common stock, *for both capital and arrears of dividend.*

It is also assumed that elimination in total of inter company profits on unsold inventories and securities means elimination of the *whole* profit from the profits of the combine, regardless of the interests of outside shareholders.

CALCULATIONS FOR CONSOLIDATION OF COMPANIES 2 AND 3

1. Net worth of no par common stock of Co. 2, 1/4/43*			$ 236,600
Share of Co. 3 in Co. 2 $\frac{5,250}{21,000}$ i.e. ¼			59,150
Paid by Co. 3			50,375
Capital Reserve			$ 8,775
2. Net worth of Co. 2, 30/9/46			$ 758,500
Share of Co. 1 in Co. 2 $\frac{23,200}{42,000}$			418,981
Paid by Co. 1			320,000
Capital Reserve			$ 98,981
Net worth of Co. 2, 15/8/47			$ 776,500
Co. 1's share $\frac{4,200}{42,000}$			77,650
Paid by Co. 1			64,000
Capital Reserve			$ 13,650
3. Interest of outside shareholders of Co. 2			
Capital: $\frac{4,100}{42,000}$ x 482,500			$ 47,101
Surplus $\frac{4,100}{42,000}$ x 312,000			30,457
			$ 77,558
Interest of Co. 1 in Co. 2			
Paid		$ 384,000	
Capital reserve	$ 98,981		
	13,650	112,631	
Surplus since 30/9/46 and 15/8/47:			
$\frac{27,400}{42,000}$ x 90,000 (profit, year to 31/3/48)	58,714		
$\frac{23,200}{42,000}$ x (222,000 - 276,000) Decrease	—29,828		
$\frac{4,200}{42,000}$ x (222,000 - 294,000) Decrease	— 7,200	21,686	518,317

***Editor's Note: It would be quite appropriate to calculate Reserve on consolidation as from the date in which Co. 1 and its subsidiary Co. 3 acquired control of Co. 2, i.e. September 30, 1946, rather than the date of the purchase of the shares by Co. 3, i.e. April 1, 1943.**

Interest of Co. 3 in Co. 2			
Paid 1/4/43		50,375	
Stock dividend 31/3/46		65,625	
		116,000	
Share of profits since acquisition:			
to 31/3/47 ¼ of (222,000 - 16,600)	$ 51,350		
year to 31/8/48 ¼ of $90,000	22,500	73,850	189,850

4. CONSOLIDATED BALANCE SHEET OF COS. 2 AND 3 AT MARCH 31, 1948

Assets: Co. 2		$ 1,102,000	
Co. 3	$ 420,000		
Less: Investment in Co. 2	116,000	304,000	1,406,000
Accounts payable: Co. 2 $107,500; Co. 3. $48,000			155,500
1st Mortgage 6% Bonds: Co. 2 $200,000; Co. 3 $80,000			280,000
Outside shareholders of Co. 2			77,558
Interest of Co. 1 in Co. 2			518,317
Capital Stock: Co. 3. 6% Preferred			80,000
Common, par $100			160,000
Surplus, Co. 3 1/4/47		60,000	
Add: Share of Co. 2's surplus to 1/4/47		51,350	
		111,350	
Add: Share of Co. 2's profit, year to 31/3/48	22,500		
Less: Loss of Co. 3, year to 31/3/48	8,000	14,500	125,850
Capital reserve of Co. 3 in Co. 2			8,775
			$1,406,000

5. To consolidate the balance sheet of Cos. 2 and 3 with that of Co. 1.

Preferred shares of Co. 3 1/4/40: Capital	80,000	
Arrears of dividend, 1 year to 31/3/40	4,800	84,800
Attributable to Co. 1's 50% holding		42,400
Paid by Co. 1		34,000
Capital Reserve		$ 8,400
Net worth of Co. 3, 1/4/41		$ 214,000
Less: Attributable to preferred shares: Capital	80,000	
Arrears of dividend, 2 years to 31/3/41	9,600	89,600
Net worth of common stock, 1/4/41		$ 124,400
Attributable to Co. 1's holding: $\frac{1520}{1600}$		$ 118,180
Paid by Co. 1		126,000
Goodwill		$ 7,820

6. Note that, since Co. 1 has received all arrears of dividend on its holding of preferred shares in Co. 3, it has clearly made an error of principle in not crediting the dividend of $2,400, received for the year to 31/3/40, to the $34,000 investment. This amount of $2,400 was provided for in calculating the capital reserve at date of acquisition and must therefore be regarded as included in the purchase price of $34,000. Since the investment still appears at this figure on Co. 1's balance sheet the dividend of $2,400 must presumably have been credited to surplus. Before consolidating, therefore, Co. 1's investment must be reduced to $31,600 and its surplus at 1/4/47 to $242,600.

7. Outside shareholders of Co. 3.

Preferred shareholders		$ 40,000	
Common stock: Capital	8,000		
Surplus per consolidated b/s. in 4.			
Surplus, 1/4/47 $\frac{80}{1,600}$ x 111,350	5,568		
Profit, year to 31/3/48: $\frac{80}{1,600}$ x 14,500	725		
Capital reserve per consol'd. b/s in 4.			
$\frac{80}{1,600}$ x 8,775	439	14,732	54,732

8. Interest of Co. 1 in Co. 3

Paid, less dividend of $2,400 for year to			
31/3/40 (see 6. above): Preferred	31,600		
Common	126,000	157,600	
Surplus since acquisition, per consol'd. b/s. in 4.			
Surplus, 1/4/47: $\frac{1,520}{1,600}$ x (111,350 + 26,000 deficit + 9,600 pref. div. accrued 31/3/41)		139,602	
Profit, year to 31/3/48: $\frac{1,520}{1,600}$ x 14,500		13,775	
Capital reserve: $\frac{1,520}{1,600}$ x 8,775		8,336	319,313

9. CONSOLIDATED BALANCE SHEET OF COS. 2 AND 3 REDRAFTED

Assets		$ 1,406,000
Accounts payable		155,500
1st Mortgage 6% Bonds		280,000
Outside shareholders: of Co. 2		77,558
of Co. 3		54,732
Interest of Co. 1: in Co. 3		319,313
in Co. 2		518,317
Capital Reserve of Co. 1 in Co. 3	8,400	
Less: Goodwill of Co. 1 in Co. 3	7,820	580
		$ 1,406,000

10. Adjustments and eliminations in the final consolidation:

(i) Unrealised profit in inventories: Debit profits of Cos. 2 and 3, respectively, with $24,000 and $10,200, and credit inventory of Co. 1 with $34,200.

(ii) Securities: Credit profits of Co. 2 with $2,500, debit profit of Co. 1 with $4,800 and debit securities of Co. 3 with $2,300.

(iii) Inter company debts: Credit debtors of Co. 2 with $66,000 and of Co. 3 with $5,000: debit creditors of Co. 1 with $65,000 and of Co. 3 with $6,000.

11. CONSOLIDATED BALANCE SHEET OF COMPANIES 1, 2 AND 3

AS AT MARCH 31, 1948

Cash			$ 176,000
Inventories		$ 418,000	
Less: Unrealised profit		34,200	383,800
Other current assets		412,000	
Less: Inter co. debts		71,000	341,000
Securities		68,000	
Less: Unrealised net profit		2,300	65,700
Fixed assets, less depreciation			2,214,000
			$ 3,180,500
Accounts payable and accrued expenses		366,500	
Less: Inter co. liabilities		71,000	295,500
6% Bonds due 1st July, 1960			200,000
1st Mortgage 6% Bonds			680,000
Outside shareholders: of Co. 2			77,558
of Co. 3			54,732
6% Cumulative Preferred Stock, par $100: Co. 1			400,000
Common Stock, par $100: Co. 1		740,000	
Surplus, 1/4/47:			
Co. 1, less dividend adjustment (as in 6.)	242,600		
Co. 3	139,602		
	382,202		
Less: Decrease in surplus, Co. 2	37,028	345,174	
Profit, year to 31/3/48: Co. 1, less unrealised profit on securities, $4,800	225,200		
Co. 2 (58,714 — 24,000 inventory adjustment + 2,500 on securities)	37,214		
Co. 3 (13,775 — 10,200 inventory adjustment)	3,575	265,989	
			1,351,163
Capital Reserve: Co. 1 in Co. 2		112,631	
Co. 1 in Co. 3		580	
Co. 1 in Co. 2, through Co. 3		8,336	121,547
			$ 3,180,500

In cases such as this, where the subsidiaries are themselves inter-linked, consolidation should always start with the consolidation of such subsidiaries, the results being consolidated with the balance sheet of the holding company. At each stage the normal method of procedure is used, the consolidated balance sheet of the subsidiaries being treated as an ordinary balance sheet to be consolidated with that of the holding company, according to the usual rules. By this means accumulated profits and reserves of the subsidiaries (such as the capital reserve, $8,775, of Co. 3 in Co. 2, which emerged in the above illustration) are apportioned automatically between the holding company and outside shareholders in the final consolidation.

One final illustration will now be given, again involving three companies, with the addition of certain important practical features not yet dealt with. It will be noted that, in this case, Z Ltd. is directly the holder of only a bare 50% interest in F Ltd., but indirectly, through its control of W Ltd. by means of a two-thirds holding of common shares, it controls another one-third of the shares of F Ltd. F Ltd. is, therefore, both a subsidiary and a sub-subsidiary of Z Ltd., which has effective control. It will also be noted that the holding company here pays for shares in a subsidiary on the basis of a different value for the subsidiary's plant from that which appears on the subsidiary's balance sheet. This must be taken into account in calculating the goodwill or capital reserve on acquisition. Bulletin 24 of the Committee on Accounting Procedure, American Institute of Accountants, contains the following statement in this connection:

> Where a parent corporation has made a stock investment in a subsidiary, at a cost in excess of its equity in the net assets of the subsidiary, as shown by its books at the date of acquisition, the parent corporation may have (a) paid amounts in excess of book value for specific assets of the subsidiary or (b) paid for the general goodwill of the subsidiary. If practicable such an excess should be divided as between tangible and intangible assets . . .

The position will be safeguarded, and the matter made easy for the student, if he adjusts the balance sheet of the subsidiary (e.g. in an examination question) by altering the figures for the asset in question to the holding company's valuation and completing the double entry through a reserve or, if the asset is being reduced, a debit to profit and loss account on the actual balance sheet. If the asset is being increased and there is no reserve already on the balance sheet to be correspondingly increased, then a balancing reserve must be raised. The valuation is actually a matter only for the holding company and only the holding company's share of the increase in valuation should be added to the asset on the subsidiary's balance sheet, as is done in the following example. It is obvious that, if proper effect is not given in this way to the holding company's valuation of the asset, the goodwill or capital reserve on acquisition will be incorrectly calculated. In calculating the equity of the common shares of the subsidiary, at the date of acquisition, the reserve arising from this adjustment will be included. Finally, it should be noted that, since the asset will come on to the consolidated balance sheet at a figure increased or decreased by the holding company's share of the difference in valuation attributed to it, the surplus of the whole combine must be debited not only with depreciation on the original balance sheet valuation (as provided for in the accounts of the subsidiary), but with the holding company's share of depreciation on any excess value attributed to the asset. Should the holding company's valuation be less, then the depreciation

on the difference should be credited to the consolidated surplus. The illustration should be studied carefully for this adjustment.

ILLUSTRATION 6

The balance sheets of Z Ltd., W Ltd. and F Ltd. at 30th September, 1948, are as follows:

ASSETS

		Z Ltd.		W Ltd.		F Ltd.
		$		$		$
Investment in subsidiaries:						
W Ltd.						
2,000 common shares at cost bought 1/10/47	70,000					
F Ltd.						
3,000 shares at cost, bought 1/10/ 46......	120,000	190,000				
2,000 shares at cost, bought 1/4/48				60,000		
Plant, bal. 1/10/47			50,000			
Less: Depreciation, 10%			5,000	45,000		
Other net assets		90,000		127,750		275,000
		$ 280,000		$ 232,750		$ 275,000

LIABILITIES

		Z Ltd.		W Ltd.		F Ltd.
		$		$		$
Creditors		30,000		20,000		10,000
Capital Stock:						
1,000 5% Pref. shares of $100				100,000		
Common shares						
of $100		200,000				
of $ 25				75,000		
of $ 50					300,000	
General Reserve:						
30/9/48		35,000				
1/10/47				10,000		
Surplus: 30/9/48		15,000		27,750		
Revenue Deficit:						
F Ltd. 1/10/46	20,000					
Loss 1946/47	10,000					
Loss 1947/48	5,000				35,000	265,000
		$ 280,000		$ 232,750		$ 275,000

(i) Analysis of the surplus of W Ltd. reveals the following:

Profit, year to 30/9/48	$ 30,000
Dividends declared and paid during the year to 30/9/48:	
Pref. dividend, ½ year to 30/9/47	2,500
Pref. dividend, ½ year to 31/3/48	2,500
Final common dividend, year to 30/9/47	2,250

(ii) For the purpose of determining the price to be paid for its holding in W Ltd., Z Ltd. placed a valuation of $60,000 on W Ltd.'s plant.

Note: The preferred shares of W Ltd. have priority for return of capital on a winding up but no right to share in surplus profits and no voting power.

In no case has there been any issue of capital stock since 1/10/46.

Required: Consolidated balance sheet of the three companies at 30th September, 1948.

Solution

1. First consolidate the subsidiary, W. Ltd. and the sub-subsidiary, F Ltd., in which W Ltd. has a holding, in accordance with the rule already stated.

Calculation of Goodwill or Capital Reserve

Capital Stock, F Ltd., 1/4/48		$300,000
Less: Revenue deficit: Balance, 1/10/47	30,000	
½ loss for year to 30/9/48	2,500	32,500
* (See note below)		
Equity of Capital Stock, 1/4/48		$267,500
W Ltd.'s one-third share		89,167
Paid by W Ltd.		60,000
Capital Reserve		$ 29,167

2. *Schedules for consolidation of F Ltd. and W. Ltd.*

(i) Interest of shareholders of F Ltd. other than W Ltd.:

Z Ltd.: Capital Stock ½		$150,000
Less: Revenue deficit		
Balance, 1/10/46 ½	10,000	
Loss to 1/10/48 ½	7,500	17,500
		$132,500
Others: Capital Stock one-sixth		$ 50,000
Less: Revenue deficit, one-sixth		5,833
		$ 44,167

(ii) Interest of W Ltd.	
Paid 1/4/48	$ 60,000
Less: Share of loss, ½ year to 30/9/48:	
* one-third of (½ of 5,000)	834
	$ 59,166

3. *Consolidated Balance Sheet of W Ltd. and F Ltd., at 30th September, 1948.*

Other net assets: W Ltd.			$127,750
F Ltd.			275,000
Plant: W Ltd.			45,000
			$447,750
Creditors: W Ltd.		20,000	
F Ltd.		10,000	30,000
Interest of shareholders of F Ltd. other than W Ltd.			
Z Ltd.			132,500
Others			44,167
Capital Stock, W Ltd.: 1,000 5% Pref. shares			100,000
3,000 Common shares		75,000	
Capital Reserve: F Ltd.		29,167	
General Reserve: W Ltd.		10,000	
Surplus: W Ltd.	27,750		
Less: W Ltd.'s share of F Ltd.'s loss since 1/4/48	834	26,916	141,083
			$447,750

4. To consolidate the balance sheet of Z Ltd. with the consolidated balance sheet of W Ltd. and F Ltd., as in 3 above.

Calculation of Goodwill or Capital Reserve:

(i) of Z Ltd. in F Ltd.	
Share Capital, F Ltd. 1/10/46	$300,000
Less: Revenue deficit, F Ltd. 1/10/46	20,000
Equity of capital stock, 1/10/46	$280,000
Z Ltd.'s share — ½	140,000
Paid by Z Ltd.	120,000
Capital Reserve	$ 20,000

**Note:* In the absence of any exact figures for profits of an acquired subsidiary, to date of acquisition, where such date falls part way through the subsidiary's financial year, the full year's profits should be apportioned on a time basis.

(ii) of Z Ltd. in W Ltd.

Share Capital, W Ltd. 1/10/47		$175,000
General Reserve, W Ltd. 1/10/47	10,000	
Add: Undervaluation of Plant, as agreed with Z Ltd., 1/10/47	10,000	20,000
Surplus, W Ltd. 1/10/47		5,000
		200,000
Less: Preferred Shares, 1/10/47:		
Par value	100,000	
*Dividend, ½ year to 30/9/47	2,500	102,500
Equity of Common Stock		$ 97,500
Z Ltd.'s holding — two-thirds		65,000
Paid by Z Ltd.		70,000
Goodwill		5,000

5. *Adjustments for final consolidation*

(i) Due to outside shareholders of W Ltd.

5% Preferred Shares: Par	$ 100,000	
Add: Div. ½ year to 30/9/48	2,500	102,500

The provision for this dividend will be subject to the same considerations, relative to conditions at the date of consolidation, as stated in the note in 4. above.

Common Shares: Par, one-third	$ 25,000	
General Reserve: one-third	3,333	
Surplus: one-third (after deducting pref. div. accrued $2,500)	8,139	
Capital Reserve	9,722	46,194

(ii) Interest of Z Ltd.

(a) Paid on acquisition of W Ltd.	$ 70,000	
Less: Div. from pre-acquisition profits: two-thirds of $2,250	1,500	68,500

N.B. The balance sheet of Z Ltd. must be corrected, as in Illustration 5, by crediting the investment in W Ltd. and debiting profit and loss account with the $1,500, which Z Ltd. must obviously have credited to profit and loss account on receipt.

(b) Z Ltd.'s share of profits of W Ltd. since acquisition: two-thirds of ($30,000 - 5,000 pref. div.)	$ 16,667
Less: two-thirds of W Ltd.'s share of F Ltd.'s loss since 1/4/48	556
	$ 16,111

* Note: If there had been no profits in either accumulated surplus or general reserve of W Ltd., out of which to pay this dividend, no provision could have been made for it here, except on the expressly stated assumption that the priority extended to arrears of dividend as well as to capital (as in Illustration 5).

Less: Special reserve for depreciation of plant 10% of \$6,667 (see item (iii) below)	667
	\$ 15,444

(c) Z Ltd.'s share of capital reserve of F Ltd., created since 1/10/47: two-thirds of \$29,167	\$ 19,445

(d) Z Ltd.'s interest in F Ltd.	
Paid on acquisition, 1/10/46	\$ 120,000
Less: ½ loss since 1/10/46	7,500
	\$ 112,500
Add: Capital reserve on acquisition	20,000
	\$ 132,500

(iii) Addition to plant of W Ltd.	
Two-thirds of \$10,000 excess valuation on acquisition of shares by Z Ltd.	\$ 6,667
Note: Depreciation on this increase must be charged against Z Ltd.'s profits, since W Ltd. is providing depreciation only on its own book value (see (ii) (b) above) Z Ltd.'s depreciation will then be	\$ 5,667

6. The final consolidation can now be made, bearing in mind the adjustment required for the error on Z Ltd.'s balance sheet, referred to in 5. (ii) (a) above.

CONSOLIDATED BALANCE SHEET OF Z LTD., W LTD. AND F LTD.

AS AT SEPTEMBER 30, 1948

Other Net Assets:		
Z Ltd.		\$ 90,000
W Ltd.		127,750
F Ltd.		275,000
Plant: W Ltd., less depreciation		51,000
Goodwill: W Ltd.		5,000
		\$ 548,750
Creditors:		
Z Ltd.	\$ 30,000	
W Ltd.	20,000	
F Ltd.	10,000	\$ 60,000
Shareholders of F Ltd. outside the combine		44,167
Shareholders of W Ltd. outside the combine:		
Preferred stock		102,500
Common stock		46,194

Capital stock: Z Ltd.			
Common stock: 2,000 shares of $100 each			200,000
Capital reserve: F Ltd.: direct		20,000	
through W Ltd.		19,445	39,445
General reserve: Z Ltd.			35,000
Surplus: Z Ltd. (after adjustment of error)		13,500	
W Ltd.		16,667	
		30,167	
Less: Share of loss of F Ltd.: direct	$ 7,500		
through W Ltd.	556	8,056	
		22,111	
Less: Special reserve, depreciation of plant of W Ltd.		667	21,444
			$ 548,750

It would be easy and desirable, if space permitted, to introduce further illustrations, in which practical difficulties not already mentioned could be dealt with. But none of these complexities will alter the basic treatment of consolidation by the method indicated. A student who has mastered the method here illustrated for examination purposes can, without many working papers but with full detail, produce his consolidated balance sheet speedily, methodically and wholly logically, in such a manner that the final consolidation is almost automatic. What is needed is a thorough understanding of the basic rules and ability to use them without hesitation. The theory underlying these rules must be thought out and the rules themselves memorized. After that a little practice will soon make the student familiar with the procedure required. The essential thing is to ensure that, on the consolidated balance sheet, the final figures to the credit of reserves and surplus correctly reflect the amounts at the disposal of the controlling company. The figure to the credit of surplus must tally with the figure shown as attributable to the holding company in the consolidated profit and loss statement of the combine. The preparation of such a consolidated statement is itself a matter for further study and practice by the student. These consolidations must never be done mechanically, for they are all obviously based on reason, and the student must argue the matters out with himself and not rest content until he fully understands them. It is to be hoped that he will learn to relish the challenge to his logical powers which such exercises give, and that he will soon make himself proficient in a phase of accounting which has today assumed such great importance.

The Students' Department

J. E. Smyth, C.A., Editor

NOTES AND COMMENTS

ONE OF THE THINGS that dates us rather badly these days and makes us feel that we should be respected for our old age, if for no other reason, is that our edition of *Auditing Theory and Practice* by R. H. Montgomery, the one we used as a student, is only the sixth edition. We now have before us the seventh edition (Ronald Press, New York, 1949).

There are two or three things about this new edition that seem to us well worth mentioning. We are not going to pretend we have read the whole of it by any manner or means, but this of course is only a minor hindrance in the way of our commenting extensively upon it. In the first place, the new title of the book is, in a way, a recognition of the acceptance it has gained for itself, and deserved. It is called, simply, *Montgomery's Auditing*. Two other authors are now named in addition to R. H. Montgomery—N. J. Lenhart and A. R. Jennings of the same firm of accountants.

Secondly, a surprising thing about the new edition is that it is actually seventeen pages *shorter* than its predecessor! This is a highly commendable feat in itself, and we cannot help observing that the authors must really know what internal control means.

The revision appears to have been a very thorough one. A chapter is now devoted to each of the "short-form" and "long-form" audit reports suggested for use in the United States and there is another chapter on Procedure under the Federal Securities Acts. While these chapters may not be of direct use to Canadians, a quick reading will throw interesting light on developments to the south of us, and this is certainly something one cannot completely disregard. At any rate we do not regret scanning through them. An appendix has been added and would appear to be of very wide application. It consists of questionnaires for the evaluation of internal control in various types of businesses. The questionnaires are in our opinion a most useful addition.

* * *

Montgomery evidently believes that the proof of the pudding lies in the eating. He seems to take the comforting view that the present form of our financial reports cannot be as bad as some people say or the form would not have survived this long. ("If it were really important, there would have been more changes than have taken place in the thirty-seven years since the first edition of this book.") He also suggests that it is what financial statements contain, and not the manner in which they may happen to be drawn up, that counts. In this latter connection we cannot resist passing on just this one quotation from his new Preface:

I doubt the practicality, or for that

matter the desirability of endeavouring to make financial statements clear to the uninformed. We are told that 90 per cent of the informed look only at net earnings, earnings per share and the comparisons with the preceding fiscal period. I therefore suggest that students in accounting courses take notice of the attempts, over a long period of years, of some of us to clarify financial statements and our inability to make more than a few changes in form. We have made much progress in disclosure and other important phases of fact.

Obviously no financial statements should be permitted to be issued which fail to disclose all material information regarding operations and financial position. Of less importance is the method of disclosure. In my opinion when full disclosure has been made of all pertinent information both the informed and the uninformed should be able to get all they need. The uninformed will never understand but they have no basis for complaint. The informed get all they need and can form their own conclusions. Needless to say these conclusions differ widely.

Almost reactionary, isn't it? Certainly an interesting and somewhat different angle. We particularly like the part about the uninformed not having any basis for complaint. In fact, we have not seen the uninformed disposed of so neatly for a long time now.

CORRESPONDENCE

Winnipeg, Manitoba

Sir: Professor Smails in his letter published in the Students' Department, June 1949 referring to my earlier letter (May 1949 edition), has asked me two questions which I am pleased to answer. First, I would not deny that the almost universal practice is to head one side of the balance sheet with the word "Assets".

In his second question he wrongly infers that I have arrived at the conclusion that there is no implication that an item set down on that side of the balance sheet is an asset. What I did say is that in the normal use of the term "Deferred Charge" there is no necessary implication that such a charge constitutes an asset. It is meant to indicate simply the postponement of a charge or expense which has been incurred so as to give effect to such expense in future income statements.

The only reasonable justification for showing deferred charges on the asset side is that of technical necessity. It would appear to be a lesser evil to include a deferred charge on the asset side, possibly following a sub-total representing total genuine assets, than to deduct it from the par value of the bond liability thus understating the total liabilities. Why should the total liabilities of two companies with identical bond issues outstanding differ solely because in one case the bonds were issued at par and in the other case at a discount?

To the informed reader of balance sheets, however, the picture presented is the same, whichever method of presentation is used and admittedly there are grounds for argument either way.

The point I wish to stress, however, is that the average student regards published solutions as authoritative, regardless of printed warnings to the contrary. Whenever solutions contain features differing from accepted practice, or deal with issues where more than one school of thought prevails, the maximum benefit to the student would be obtained if attention were drawn in the solutions to the possibility of optional methods of treatment.

William H. Gray

* * * *

Calgary, Alberta

Sir: The proper treatment of a deficit in the balance sheet eludes me. I have searched Finney, Smails, Montgomery and others to no avail and the only definite statement on the subject to be found in my limited

library is from Husband and Thomas "Principles of Accounting" which reads: "A deficit should be shown as a contra deduction from capital stock; it should not be exhibited among the assets."

Armed with this intelligence I was therefore surprised and dismayed to note the treatment of a deficit in the answer to question 4, Accounting IV, Examination Problems and Solutions, 1944 (p. 119). In this presumably model solution the deficit was arrayed with the assets.

Furthermore, if it be admitted that deficits ought to be deducted from share capital or proprietorship, what is to be done if the deficit exceeds the share capital or proprietorship? [Student's name withheld on request]

Editor's reply:

We find it fascinating to think that three of our leading authors should have neglected to put the deficit in its place. Perhaps it is because we hardly know what a deficit looks like these days (thank goodness).

This is a subject on which we have the strongest personal views. We think it is impossible to contend seriously that a deficit is an asset. And if it is not, it has no right to be on the asset side of a balance sheet. A deficit represents a depletion of proprietorship through successive losses. There is no more fundamental rule in accounting than the one that profits tend to increase net assets (i.e., proprietorship) and losses to reduce net assets. Therefore the deficit should appear as a deduction from share capital in the proprietorship section.

There cannot be any balance sheet of a going concern when the deficit exceeds the capital stock. The company would be very bankrupt indeed by the time it reached this stage because its liabilities would exceed its assets (including even fixed assets).

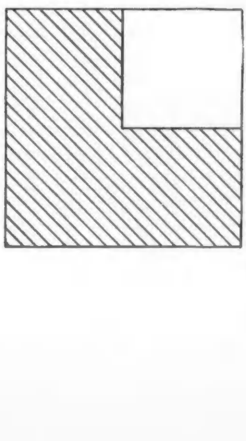
We wince to think that these pages once contained the travesty of accounting logic just now brought to light, but then the solution is almost five years old, and in about one more year criticism of it would have been statute barred! (At least according to our interpretation of the Statute of Limitations it would.)

The Foreword to the Problems and Solutions section is intended to avoid the impression that the published solutions are "model". There are often somewhat different ways of handling a problem and differences of opinion still exist on certain points of accounting theory. To describe a solution as model is to suggest by implication that there is no other acceptable (or in this case, we think, better) way of working it. We doubt if any accountant would be prepared to submit solutions for publication on that basis.

PUZZLE

A certain section of land is in the shape of a perfect square. A farmer owns three-quarters of the section, as shown by the shaded area of the square.

The farmer dies and leaves the land to his four sons. Each of the four sons is to have a portion equal in area and similar in shape. How is the land divided?



PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect of course the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM 1

Intermediate Examination, November 1948

Accounting I, Question 8 (15 marks)

You are required to prepare the bank reconciliation as at 31st December 1947, for DEF Company Limited.

Set out below are the following records of the DEF Company Limited:

(a) Bank reconciliation as at 30th November, 1947;

(b) Transcript of those columns of the cash book recording bank transactions during December 1947;

(c) Copy of the statement for the month of December 1947 which has been received from the bank.

The paid cheques returned by the bank have been compared with the bank statement and with the cash book. The candidate is assured that the check mark "/" signifies agreement between the bank statement and the records of DEF Company Limited in respect of the items so marked, but other items have not been compared and may be in error.

(a) **DEF COMPANY LIMITED**

BANK RECONCILIATION

30th November 1947

Balance per bank statement, 30th November, 1947		$ 701.21
Add: Outstanding deposit	$1,346.35	
Cheque of DED Company charged by bank to DEF Company, 17th November	212.10	
		1,558.45
		$2,259.66
Less: Outstanding cheques:		
Nos.		
490	111.11	
6	70.89/	
7	54.18/	
8	43.45/	
500	50.12/	
1	61.40/	
19	80.15/	
23	42.75/	
26	60.25/	
27	411.24/	
528	174.10	
		1,159.64
Balance per cash book, 30th November, 1947		$1,100.02

(b)

DEF COMPANY LIMITED

Cash Book

Dec. 1947			Cheque No.	Bank Debit	Bank Credit
1	Balance			$ 1,100.02	$
1	Deposit			1,124.31	
	Can. Pac. Express		529		121.34/
	Can. Nat. Express		530		83.50/
2	Deposit			1,256.56	
3	Deposit			969.54	
4	Deposit			1,320.30	
5	Deposit			1,414.14	
6	Deposit			1,450.50	
8	AB Co. Ltd.	Accounts Payable	531		392.21/
	Bifitters Co.	"	2		403.50/
	Canamada Mfgrs.	"	3		616.61/
	Driem Cup Ltd.	"	4		205.13/
	Gabby Perfumery	"	535		121.00/
	Heady Hats	"	6		325.00/
	Hippy Coat Co.	"	7		176.00/
	Johnson Mfg.	"	8		89.45/
	Kanada Kompany	"	9		92.70/
	Lawrence Lowland Ltd.	"	540		340.16
	Lakeville Realty	"	1		412.44/
	Manymen's Clothiers	"	2		213.54/
	Manufacturing Co. Ltd.	"	3		600.12/
	Misses Coat Company	"	4		110.25/
	No Fit Clothing	"	545		133.65/
	No Like Materials	"	6		145.60
	Obvious Advertisers	"	7		213.40/
	Office Stationers	"	8		231.54/
	Pretty Dresses Inc.	"	9		345.45/
	Pallsy Dog Leash	"	550		512.61
	Restful Overall Co.	"	1		277.36
	Sparetime Repair Co.	"	2		101.05/
	Thrilling Cosmetics	"	3		522.43/
	Unwearaldi Shoes	"	4		78.90/
	Xtra Special Clothiers	"	555		239.34
	C.P. Express		6		273.26/
	C.N. Express		7		100.19/
	Deposit			1,390.03	
9	Deposit			1,402.40	
10	Deposit			1,001.25	
11	Deposit			1,534.62	
12	Deposit			1,530.25	
13	Drafts collected			1,212.10	
	Deposits			1,748.90	
15	Drafts collected			674.19	
	C.P. Express		558		343.40/
	C.N. Express		9		121.31/
	A. Adams	Payroll	560		43.45/
	B. Bruce	"	1		50.26/

	D. Donaldson	"	2		70.89/
	E. Dudley	"	3		61.36/
	G. Gordon	"	4		25.18/
	F. Hanley	"	565		80.15/
	H. Higgins	"	6		60.25/
	K. Kaye	"	7		62.31/
	L. Lorne	"	8		54.18/
	S. Sanderson	"	9		48.36/
	E. Smith	"	570		48.36/
	E. Smythe	"	1		42.75/
	T. Thomas	"	2		50.12/
	J. Tomlinson	"	3		55.18/
	W. Thomson	"	4		43.45/
	V. Vivan	"	575		60.25
	K. Walker	"	6		54.18/
	T. Wiley	"	7		61.40/
	S. Wilson	"	8		25.18/
	W. Woods	"	9		62.31/
	Y. Yeo	"	580		50.12/
	Receiver General (income tax deductions)		1		427.82/
	Receiver General		2		28.34/
	Deposit			1,454.20	
16	Deposit			1,621.13	
17	Deposit			1,345.48	
18	Deposit			1,630.48	
19	Deposit			1,645.23	
	Drafts collected			400.00	
	A. Adams	Bonus	583		15.00/
	B. Bruce	"	4		20.00/
	D. Donaldson	"	585		25.00/
	E. Dudley	"	6		20.00/
	G. Gordon	"	7		15.00/
	F. Hanley	"	8		25.00/
	H. Higgins	"	9		20.00/
	K. Kaye	"	590		20.00/
	L. Lorne	"	1		20.00/
	S. Sanderson	"	2		15.00/
	E. Smith	"	3		20.00/
	E. Smythe	"	4		20.00/
	T. Thomas	"	595		15.00/
	J. Tomlinson	"	6		20.00/
	W. Thomson	"	7		20.00/
	V. Vivan	"	8		20.00/
	K. Walker	"	9		10.00/
	T. Wiley	"	600		20.00
	S. Wilson	"	1		20.00/
	W. Woods	"	2		15.00/
	Y. Yeo	"	3		15.00/
	Deposit			2,020.43	
22	Deposit			1,954.83	
	C.P. Express		604		312.16/
	C.N. Express		5		113.12/

23	Deposit			2,124.61	
24	Deposit			2,230.59	
27	Deposit			845.26	
30	Deposit			789.18	
31	A. Adams	Payroll	606		43.45/
	B. Bruce	"	7		50.26
	D. Donaldson	"	8		70.89
	E. Dudley	"	9		61.36
	G. Gordon	"	610		25.18/
	F. Hanley	"	1		80.15
	H. Higgins	"	2		60.25
	K. Kaye	"	3		62.31
	L. Lorne	"	4		54.18
	S. Sanderson	"	615		48.36
	E. Smith	"	6		48.36
	E. Smythe	"	7		47.25/
	T. Thomas	"	8		50.12
	J. Tomlinson	"	9		55.18
	W. Thomson	"	620		43.45
31	V. Vivan	Payroll	621	$	$ 60.25
	K. Walker	"	2		54.18/
	T. Wiley	"	3		61.40
	S. Wilson	"	4		25.18
	W. Woods	"	625		62.31/
	Y. Yeo	"	6		50.12
	Receiver General (income tax deductions)		7		427.82
	Receiver General		8		34.50
	Deposit			932.12	
	C.P. Express		629		146.18
	C.N. Express		630		70.21
	Coal Co. of Canada		1		568.49
	Light & Power Co. Ltd.		2		121.30
				$38,122.65	$12,806.26
	Balance				25,316.39
				$38,122.65	$38,122.65

(c) Statement of Account

DEF Co. Ltd.,
Canada.

In account with

XYZ Bank
Someplace, Canada

Explanation of characters

- DM—Debit memo
- CM—Credit memo
- IN—Interest
- CC—Certified cheque
- CL—Collection
- OD—Overdraft
- EC—Error corrected
- RT—Returned item
- D —Discount
- EX—Exchange

							Cheques		
							Deposits	Date	Balance
								Nov. 30	$ 701.21
	$ 70.89/		$ 54.18/		$ 50.12/		$1,346.35	Dec. 1	1,872.37
	60.25/						1,124.31	Dec. 2	2,936.43
							1,256.56	Dec. 3	4,192.99
	61.40/		42.75/	EX	.75	CL	512.19		
							969.54	Dec. 4	5,569.82
	43.45/		83.50/				1,320.30	Dec. 5	6,763.17
							1,414.14	Dec. 6	8,177.31
							1,450.50	Dec. 8	9,627.81
DM	.25						1,390.03	Dec. 9	11,017.59
	121.34/		78.90/		92.70/	EC	212.10		
							1,402.40	Dec. 10	12,339.15
	403.50/		89.45/	EX	.90		1,001.25	Dec. 11	12,846.55
	80.15/		392.21/		600.12/				
	411.24/		121.00/		392.21	CL	1,212.10		
	205.13/		213.54/		176.00/		1,534.62	Dec. 12	13,001.67
	213.40/	EX	.70		522.43/	CL	614.19		
	616.61/		110.25/		273.26/		1,530.25	Dec. 13	13,409.46
	43.45/		62.31/		80.15/				
	70.89/		100.19/		48.36/				
	54.18/		60.25/		62.31/				
	25.18/		50.26/		43.45/		1,748.90		
	48.36/		61.36/	CC	28.34/	EC	392.21	Dec. 15	14,711.53
	412.44/		325.00/		55.18/				
	101.05/		25.18/		133.65/				
	345.45/		42.75/	EX	.50	CL	400.00		
	231.54/		54.18/		50.12/		1,545.20	Dec. 16	14,879.69
	343.40/	RT	114.12		61.40/		1,621.13	Dec. 17	15,981.90
	121.31/						1,345.48	Dec. 18	17,206.07
	50.12/		427.82/				1,630.48	Dec. 19	18,358.61
	15.00/		25.00/		15.00/				
	20.00/		20.00/		20.00/				
	20.00/		20.00/		15.00/	CL	634.50		
	25.00/		15.00/		20.00/		114.12		
	15.00/		10.00/		15.00/		1,645.23	Dec. 20	20,482.46
	20.00/	DM	.85		20.00/				
	20.00/		20.00/		20.00/		2,020.43	Dec. 22	22,402.04
							1,954.83	Dec. 23	24,356.87
	312.16/		113.12/				2,124.61	Dec. 24	26,056.20
							2,230.59	Dec. 27	28,286.79
	614.16						845.26	Dec. 30	28,517.89
	47.25/		54.18/		62.31/				
	25.18/	CC	34.50		43.45/		798.18	Dec. 31	29,049.20

DEF COMPANY LIMITED

Bank Reconciliation

As at 31st December 1947

Balance per Bank Statement		$ 29,049.20
Less outstanding cheques:		
No. 490	$111.11	
528	174.10	
540	340.16	
546	145.60	
550	512.61	
1	277.36	
5	239.34	
575	60.25	
600	20.00	
607	50.26	
8	70.89	
9	61.36	
611	80.15	
2	60.25	
3	62.31	
4	54.18	
615	48.36	
6	48.36	
8	50.12	
9	55.18	
620	43.45	
1	60.25	
3	61.40	
4	25.18	
6	50.12	
7	427.82	
9	146.18	
630	70.21	
1	568.49	
2	121.30	
		4,096.35
		$ 24,952.85
Add outstanding deposit	$ 932.12	
Cheque charged in error 31 Dec.	614.16	
		1,546.28
		$ 26,499.13

Balance per Cash Book		$ 25,316.39
Add collections not entered:		
Dec. 3	$ 512.19	
Dec. 20	634.50	
		1,146.69

x Errors in recording deposits:			
Dec. 15	$ 91.00		
Dec. 30	9.00		
		100.00	
		$ 26,563.08	
Less: Interest and Exchange not entered:			
Dec. 3	.75		
9	.25		
11	.90		
13	.70		
16	.50		
22	.85		
		3.95	
x Error in recording deposit:			
Dec. 15		60.00	
			$ 26,499.13

Certified cheque outstanding No. 628 Receiver General $34.50

x These adjustments may be made to the Bank Balance rather than to the Ledger Balance.

PROBLEM 2

Intermediate Examination, November 1948

Accounting II, Question 1 (10 marks)

The directors of a manufacturing company which owns a large amount of valuable plant and machinery decide to keep a "Plant Ledger", and seek advice from their auditor as to how this ledger should be kept, what information it should contain and how depreciation should be dealt with.

Required:

Prepare a memorandum, setting out the auditor's advice to the directors.

A SOLUTION

PLANT REGISTER

Points to be covered:

1. The register should be kept as a subsidiary ledger and agree with the Plant and Machinery controlling account in the general ledger. A loose-leaf ledger facilitates handling and arranging the detail.
2. A record should be kept of each unit of plant and machinery classified as to type and location.
3. Information shown for each unit should include:
   —description, identification and location
   —date of acquisition, new or used
   —original costs and installation costs
   —estimated working life
   —estimated scrap value
   —rate of depreciation (and perhaps depreciation—see below)
   —additions or retirements
   —final disposition

Viz.,

Unit (description and location): .... Folio:			
Date acquired:			
	New)		
	Used)		
	Reconditioned)		
Estimated working life: .... years.			
	Date retired from service:		
Estimated scrap value: $....................			
	Disposition:		
Depreciation rate: ....%			
	Proceeds of Sale: $....................		
Remarks:			
	Removal Expense: $....................		
Date	Details	Amount	Balance
	Original costs:	$	$
	Installation costs:		

4. A Depreciation ledger should be set up to correspond with the plant register unit by unit, and depreciation should be calculated for each unit separately with the corresponding provision being kept distinct. This can be handled by showing provisions for depreciation on the same sheet as the asset in the Plant Register. The total of the provision for depreciation should agree with the general ledger control.
   Or
   Alternatively, bulk depreciation rates might be used. These rates are calculated for each classification of plant. Upon disposal of any units of plant no adjustment is made for over- or under-provision, in order to compensate for corresponding errors in other units.

Unit (description & location): .... Folio:			
Value of asset: $.................... Date acquired:			
Depreciation rate: ....% Remarks:			
Date	Details	Amount	Balance
		$	$

5. Depreciation should be recorded monthly in order to keep all accounts up to date and have recent information for cost and administrative purposes.

PROBLEM 3

Final Examination, November 1948

Accounting III, Question 1 (15 marks)

The following is the Balance Sheet of the Harris & Worry Company Limited as at 30th September 1948:

Assets

Current		
Cash on hand and in bank		$ 15,700
Accounts receivable:		
Trade accounts, due in 1948	$ 92,500	
Trade accounts, due in 1949	46,000	
Advances for purchases of shares	3,500	

Advances to employees	2,000			
		$ 144,000		
Less reserve for doubtful accounts		10,000		
			134,000	
Inventories, at lower of cost or market				
Raw materials		$ 25,000		
Work in process		60,000		
Finished goods on hand		21,000		
Finished goods in bonded warehouse		11,000		
Tools and supplies		16,000		
			$ 133,000	
Prepaid expenses			1,600	
				$ 284,300
Investments				
Mortgage receivable (from sale of property)			$ 12,500	
Investment at cost (85% owned) in subsidiary company			565,000	
				577,500
Fixed Assets at cost				
Land			$ 192,500	
Buildings and machinery		$1,368,730		
Less reserve for depreciation		320,400		
			1,048,330	
				1,240,830
Patents—less amortization				410,620
Goodwill				625,400
				$3,138,650

LIABILITIES AND CAPITAL

Current Liabilities		
Accounts payable — trade	$ 124,000	
Accrued liabilities	3,400	
Income taxes payable	6,250	
Dividend payable	30,000	
Mortgage instalment due 1st January 1949	25,000	
		$ 188,650
Mortgage payable		400,000
Reserve for contingencies		500,000
Capital Stock		
Authorized 1,000,000 shares no par value		
Issued 80,000 shares	$1,150,000	
Earned surplus	900,000	
		2,050,000
		$3,138,650

The Harris & Worry Company Limited wishes to borrow funds from a chartered bank for the purposes of expansion and the financing of expanded operations. The president has approached the manager of a local bank and has requested the auditor of the company to write a letter to the manager reporting only on those assets on the security of which the bank would be able to advance funds to the company.

Required:

The letter the auditor would send to the bank manager. Make such assumptions as to the value for loan purposes of the items shown on the above Balance Sheet, as you consider necessary for your answer.

A SOLUTION

Mr. J. A. McKenzie, Manager,
Crown Bank of Canada,
Earlscourt Branch,
Montreal, P.Q.

Dear Mr. McKenzie:

In accordance with instructions from our client, The Harris and Worry Company Limited, we are writing to report on the assets of the company which would provide possible security for a bank loan. We are also enclosing for your convenience copies of the audited balance sheets of The Harris and Worry Company Limited and its subsidiary, Thompson Products Limited, as of September 30, 1948.

Accounts receivable

The trade accounts shown on the balance sheet of The Harris and Worry Co. Ltd. have originated through sales of goods in the usual course of business, and are, therefore, available as security. The reserve for doubtful accounts applies entirely against the trade accounts, and, in our opinion, when deducted from the trade accounts receivable, presents a fair picture of the amount which should be collected in respect of the trade accounts outstanding at September 30, 1948, viz.,

Trade accounts, due in 1948	$ 92,500	
Trade accounts, due in 1949	46,000	
	138,500	
Less reserve for doubtful accounts	10,000	
		$128,500

Inventories of raw materials, work in process, and finished goods

These assets are valued "at lower of cost or market". "Market" as used here means replacement cost to the company. This method of valuation has been used consistently by the company for a number of years and is widely accepted as the method producing the most useful measure of income. Since prices have been rising, the components of inventory are valued in fact at original cost, rather than at "market". The work in process was, on the average, about 60% completed as of September 30, 1948. In our opinion there are no obsolete or unsalable items in any of the inventories.

The following were the realizable values of inventories which might be put up as security under sec. 88 of *The Bank Act*, as of September 30, 1948:

Raw materials (replacement cost)	$ 30,000
Work in process (replacement cost)	67,000
Finished goods (selling price)	38,000
Finished goods in bonded warehouse (selling price)	19,000
	$154,000

We are advised that the company is prepared to furnish an undertaking that these goods will be kept insured at their realizable value.

Mortgage receivable and investment in subsidiary

The mortgage receivable of $12,500 is a first mortgage and, we are advised, represents approximately 40% of the value of the property mortgaged. The company has recently

had an opportunity to sell the mortgage at par and it is believed that it could be disposed of readily at that figure.

The investment in the subsidiary represents 10,000 shares acquired October 1, 1943 at a cost of $56.50 per share. These shares presently have a quoted market value of $75.00, but since the company holds 85% of the outstanding stock, it is extremely doubtful if the entire investment could be disposed of at the market price per share quoted above.

Fixed assets

The fixed assets are valued at cost less depreciation on the balance sheet. An appraisal undertaken by The Kingsway Appraisal Co. showed the land, buildings, and machinery to have an approximate selling price of $1,800,000 as of September 30, 1948. Since there is a mortgage payable of $400,000 outstanding against the property, the company has an equity of approximately $1,400,000, based on the appraisal cited above.

It is understood of course that the bank cannot lend by way of a mortgage against fixed assets, but we are advised that the company is prepared, if need be, to furnish an undertaking that the property will not be mortgaged further without notice to the bank, and that fire insurance and either loss of profit or use and occupancy insurance will be maintained.

Accounts receivable and inventories of the subsidiary company

We suggest the possibility of the subsidiary obtaining a bank loan by hypothecating its own receivables and inventories. We are auditors also of Thompson Products Limited and in our opinion the figure for trade accounts less reserve for doubtful accounts on the balance sheet of that company represents the collectible value of those accounts ($36,500). The inventories are valued on the same basis as those of the parent company and in our opinion had a realizable value of $43,000 as of September 30, 1948.

Yours sincerely,

WATERS & WENTWORTH,

Chartered Accountants

PROBLEM 4

Final Examination, November 1948

Accounting III, Question 2 (15 marks)

Indicate which item (that is (a), (b) or (c)) in each of the following groups complies with the Act and yet sets out no more than the minimum information required to be shown on the financial statements presented to the shareholders of a public company incorporated under the Dominion Companies Act.

1. The company owns $50,000 of Dominion Government bonds, of which market value at balance sheet date is $51,200.

(a) Bonds (market value $51,200) .... $ 50,000

(b) Bonds at cost (market value $51,200) .... $ 50,000

(c) Dominion Government bonds at cost (market value $51,200) .... $ 50,000

2. There are accounts and bills receivable of $24,000 against which there is a provision of $3,500 for bad and doubtful accounts.

(a) Accounts and bills receivable (less reserve of $3,500) .... $ 20,500

(b) Accounts and bills receivable less reserve .... $ 20,500

(c) Accounts and bills receivable .... $ 20,500

3. Inventory of finished goods is valued at $15,000 on a lower of cost or market basis. A provision against future decline in prices amounting to $3,000 has also been made.

(a) Inventory of finished goods at lower of cost or market .... $ 12,000

(b) Inventory of finished goods at lower of cost or market less reserve .... $ 12,000

(c) Inventory of finished goods at lower of cost or market (less reserve of $3,000) .... $ 12,000

4. Original cost of machinery and equipment was $600,000 and there has been accumulated a depreciation provision of $20,000.

(a) Machinery and equipment at cost less depreciation $580,000
(b) Machinery and equipment at cost (less depreciation of $20,000) $580,000
(c) Machinery and equipment at book value $580,000

5. Two years ago organization expenses of $1,550 were incurred which are to be written off over a period of five years.

(a) Organization expenses .... $ 930
(b) Organization expenses (less amount written off) .... $ 930
(c) Organization expenses (less written off $620) .... $ 930

6. The company owes $14,000 in respect of income taxes, and other accounts payable amount to $56,000.

(a) Accounts and taxes payable (including estimated taxes on income $14,000) .... $ 70,000
(b) Accounts payable (including taxes of $14,000) .... $ 70,000
(c) Accounts payable including taxes .... $ 70,000

7. Patents were purchased two years ago for $5,000 and are expected to be used for five years.

(a) Patents .... $ 3,000
(b) Patents (less amount written off) .... $ 3,000
(c) Patents (less written off $2,000) .... $ 3,000

8. There is a mortgage of $20,000 owing, which is secured by the buildings, worth $25,000.

	Asset side		Liability side	
(a)	Buildings	$ 25,000	Mortgage payable	$ 20,000
(b)	Buildings (subject to mortgage)	$ 25,000	Mortgage payable	$ 20,000
(c)	Buildings (subject to mortgage, see contra)	$ 25,000	Mortgage (secured by buildings, see contra)	$ 20,000

9. There is an investment of $17,500, in various subsidiary companies. At the end of the year those companies owed $2,400 to the X Company Limited and the X Company Limited owed $1,900 to subsidiaries.

	X Company Limited Asset Side		X Company Limited Liability Side	
(a)	Investments in and net advances to subsidiaries	$ 18,000		
(b)	Investments in and advances to subsidiaries	$ 19,900	Due to subsidiaries	$ 1,900
(c)	Investments in subsidiaries	$ 17,500	Due to subsidiaries	$ 1,900
	Advances to subsidiaries	$ 2,400		

10. Authorized preferred share capital is 1,500 6% preferred shares at 100, which are redeemable at 105 at the option of the company. Of these, 1,000 are issued.

(a) Preferred shares redeemable at 105; authorized 1,500 shares at par value of 100; issued 1,000 shares $100,000
(b) Preferred shares (authorized 1,500 at 100) issued 1,000 shares $100,000
(c) Redeemable preferred shares, 1,000 shares at 100 par $100,000

Note: Marks will be given for each correct answer and marks will be deducted for each incorrect answer. Candidates are advised not to guess.

A short explanatory comment may be made in respect of any of the foregoing if it is desired to explain the reason for the item selected. If such is done a separate sheet should be used.

Instructions to candidates: These pages may be handed in with your other answer sheets after you have indicated your answers by the letters (a), (b) or (c) as instructed above.

A SOLUTION

1. (a)	4. (b)	8. (a)
2. (c)	5. (a)	9. (c)
3. (b)	6. (b)	10. (c)
	7. (a)	

Professional Notes

MANITOBA

Mr. J. D. Moran, C.A., announces the opening of an office for the practice of his profession at 919 Grain Exchange, Winnipeg.

ONTARIO

Mr. S. Stewart Joscelyn, C.A., announces that he has assumed the former practice of Mr. John H. Leckie, C.A., 677 Ontario Ave., Niagara Falls, Ont.

* * *

Mr. R. H. B. Hector, C.A., announces the removal of his office to Rms. 202-6, Confederation Life Bldg., 165 Yonge St., Toronto, Ont.

Obituary

Hugh Alexander Black

The Institute of Chartered Accountants of Manitoba reports with deep regret the death of Hugh Alexander Black.

Admitted to the Manitoba Institute in 1930, he also became a member of the Alberta Institute and served a term as president of the latter Institute. Having practised his profession in Edmonton for a number of years, he joined the Civil Service during the war and at the time of his death was director of the Canadian Government Annuities Branch. In Ottawa he was active in the affairs of the Ottawa Chartered Accountants' Club as a member and a past president of the Club.

To his widow and family, the members of the Institute extend their sincere sympathy.

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Grain Accounts Articles by W. W. McVey, D. A. B. Murray, J. Doctor, W. Aitken, G. G. James (1935) 103 pp.	1.00
Principles of Bookkeeping J. R. M. Wilson (Feb. 1944) 21 pp.	.25

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The Dominion Association of Chartered Accountants

10 Adelaide Street East — Toronto, Ont.